(1)

95-1155

Supreme Court, U.S.
FILED
JAN 17 1996
CLERK

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM 1995

CHARLES SCHUSTERMAN AND
LYNN N. SCHUSTERMAN,

Petitioners,

VS.

UNITED STATES OF AMERICA,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

*RICHARD A. FRELING
DAVID G. GLICKMAN
HOPKINS & SUTTER
1717 MAIN ST., SUITE 3700
DALLAS, TEXAS 75201
(214)653-2215

Of Counsel:
MICHAEL J. GRAETZ
127 WALL STREET
NEW HAVEN, CONNECTICUT 06511
(214)482-4829

**Counsel of Record for Petitioners*

69 pp

QUESTION PRESENTED FOR REVIEW

The question presented for review is whether the Court of Appeals for the Tenth Circuit erred in holding that the "safe harbor" interest rate prescribed by section 483 does not apply for gift tax purposes to an intrafamily installment sale, despite the fact that section 483 applies "for purposes of this title", which refers to Title 26 of the United States Code, and encompasses both the income tax provisions of subtitle A and the estate and gift tax provisions of subtitle B.

TABLE OF CONTENTS

	Page
Opinions Below	1
Jurisdictional Statement	2
Statute and Regulations Involved	2
Statement of the Case	3
Reasons for Granting the Writ	8
Conclusion	26
Appendix	A-1

TABLE OF AUTHORITIES

Page

Cases

Ballard v. Commissioner, 824 F.2d 185 (7th Cir. 1987), rev'g T.C.M. 1987-128 (1987) 7, 8, 9, 13, 21

City of Chicago v. Environmental Defense Fund, 114 S. Ct. 1588 (May 2, 1994) 11

Consumer Product Safety Commission v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980) 11

Dickman v. Commissioner, 465 U.S. 300 (1984) 24

Frazee v. Commissioner, 96 T.C. 554 (1992) 21, 23

Huntsberry v. Commissioner, 83 T.C. 742, 747-748 (1984) 11

Krabbenhoft v. Commissioner, 939 F.2d 529 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 967 (1992) 6, 7, 8, 9, 12, 21

Miller v. Commissioner, 836 F.2d 1274, 1283 (10th Cir. 1988) 11

Shannon v. United States, 114 S. Ct. 2419 (June 24, 1994) 11

United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241 (1989) 11

Statutes and Regulations

26 U.S.C. § 453 ..... 16, 17, 25, 26

26 U.S.C. § 483 ..... 2, 4, 5, 6, 7, 9, 10, 11, 12, 13, 14, 15, 16, 17, 21, 22, 23, 25, 26

26 U.S.C. § 483(a) 4, 6, 19, 20, 21, 22

26 U.S.C. § 483(c) 4, 6, 12

26 U.S.C. § 483(e) 4, 19, 20, 21, 22, 23

26 U.S.C. § 483(g) 19

26 U.S.C. § 1001 ..... 17, 25, 26

Page

26 U.S.C. § 1012 ..... 25, 26

26 U.S.C. § 1015 26

26 U.S.C. § 1274 ..... 4, 21, 22

26 U.S.C. § 1274(c)(3) 23

26 U.S.C. § 1274A 23

26 U.S.C. § 2501-2524 12

26 U.S.C. § 2512 ..... 2, 6, 12, 14, 21

26 U.S.C. § 2512(b) 5

26 U.S.C. §7701(b)(1) 10, 11, 13

26 U.S.C. § 7872 ..... 4, 21, 22, 23, 24

26 U.S.C. § 7872(f)(8) 22

Treas. Reg. § 1.483-1 2

Temp. Treas. Reg. § 15A.453-1(b)(2)(ii) 17

Temp. Treas. Reg. § 15A.453-1(c)(2)(ii) 17

Proposed Treasury Regulation § 1.1012-2 13

Proposed Treasury Regulation § 25.2512-8 13

U.S.C. Title 26 ..... 8, 10, 12

T.D. 7781, 46 F.R. 34569 (July 2, 1981) 19

Other Authorities .....

Staff of Joint Committee on Taxation, 99th Cong., 1st Sess., (Committee Print, April 23, 1985), at 9, "Description of the Tax Treatment of Imputed Interest on Deferred Sales of Property" 22

127 Cong. Rec. 17806 (July 28, 1981) Treasury Decision 7781, 46 F.R. 3456 (July 2, 1981) 20

Henderson, *Using the Imputed Interest Safe Harbor for Intrafamily Installment Sales,* 74 J. Tax. No. 2, 100 (1991) 14, 15

	Page
Kasner, *Family Installment Sales: IRS Applies Section 7872 Interest Rates,* 55 Tax Notes No. 13, 1788 (1992)	15
Manning and Hesch, *Intrafamily Sales and OID Safe Harbors; Transfer Tax Anomalies,* 17 Tax Management Estates, Gifts and Trusts Journal 131 (Sept. 10, 1992)	14
Williams, *Preparation and Promulgation of Treasury Department Regulations Under Internal Revenue Code of 1954,* 8 U.S.C. Tax Inst. 733, at 742 (1956)	14
Note, *The Safe Harbor Interest Rates Under Section 483 of the Internal Revenue Code: A Gift Tax Trap,* 20 Indiana L. Rev. 679 (1987)	14

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM 1995

CHARLES SCHUSTERMAN AND
LYNN N. SCHUSTERMAN,

Petitioners,

VS.

UNITED STATES OF AMERICA,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Tenth Circuit, whose judgment we ask the Court to review, is reported at *Schusterman v. United States of America,* 63 F.3d 986 (10th Cir. 1995), and is reprinted in the Appendix to this Petition, *infra* at p. A1-A16. The Order denying rehearing is not reported but is reprinted in the Appendix to this Petition, *infra* at p. A25. The prior opinion of the United States District Court for the Northern District of Oklahoma is reported at 94-1 U.S.T.C. (CCH) ¶60, 161 (N.D. Okla. 1994), and is reprinted in the Appendix to this Petition, *infra* at p. A17-A24.

JURISDICTIONAL STATEMENT

The Judgment of the Court of Appeals for the Tenth Circuit was published on August 22, 1995. On October 20, 1995, the Court of Appeals entered its Order Denying a Petition for Rehearing. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

STATUTE AND REGULATIONS INVOLVED

This case involves sections 483 and 2512 of the Internal Revenue Code, the texts of which are reprinted in the Appendix to this Petition, *infra* at p. A26-A28 and A29, respectively. This case also involves U.S. Treas. Reg. §1.483-1 (1975), applicable portions of the text of which is reprinted in the Appendix to this Petition, *infra* at p. A30-A36.

STATEMENT OF THE CASE

A. Lower Court Proceedings

Appellants, Charles Schusterman and Lynn N. Schusterman (hereinafter collectively the "Taxpayers"), are both residents of Tulsa, Oklahoma, and citizens of the United States of America. Respondent is the United States of America. Taxpayers filed claims for refund of gift taxes and interest with the Internal Revenue Service (hereinafter "IRS" or "Service"). After Taxpayers' claims for refund were denied, Taxpayers brought an action in the United States District Court for the Northern District of Oklahoma seeking recovery of United States gift taxes erroneously assessed against and collected from Taxpayers. After filing a Joint Stipulation of Facts, Taxpayers and Respondent each filed Motions for Summary Judgment. Taxpayers' Motion for Summary Judgment was denied and the Respondents' Motion for Summary Judgment was granted. The final Order and Judgment was entered on February 23, 1994 in favor of Respondent, and Taxpayers' case was dismissed. Taxpayers filed a timely Notice of Appeal on April 20, 1994, and the case was presented for oral argument on May 17, 1995. On August 22, 1995, the Court of Appeals for the Tenth Circuit published its opinion holding for Respondent and affirming the Order of the District Court. Taxpayers' timely filed a Petition for Rehearing and Suggestion for Rehearing En Banc, which was denied on October 20, 1995.

B. Statement of Facts

Taxpayers and Respondent have stipulated to all material facts, which in summary are as follows:

On September 21, 1980, Charles Schusterman transferred 420 shares of Tilco, Inc. ("Tilco") Class "B" common stock to five irrevocable trusts, the beneficiaries of which are his descendants (the "Trusts"). The trustees of the Trusts executed and delivered

promissory notes made payable to Charles Schusterman (the "Notes") in exchange for the Tilco stock. The principal amount of the Notes was $7,954,046.60, the undisputed fair market value of the Tilco common stock. Relying on the advice of professional advisors, Taxpayers set the interest rate on the Notes at 6% per annum, the "safe harbor" rate specified in section 483.[1] Interest rates had risen rapidly and dramatically in the early 1980s, but the Secretary of the Treasury had failed to exercise his authority and adjust the "safe harbor" rate prescribed in sections 483(a) and (c). Thus, for a period of time there was a significant gap or "spread" between the "safe harbor" rate in section 483 and prevailing market rates. By the time the Secretary of Treasury did choose to raise the "safe harbor" rate, many taxpayers had consummated transactions in reliance on the "safe harbor" rate then clearly prescribed in the statute, including the Taxpayers in this case.

---

[1] All statutory references are to the Internal Revenue Code except where otherwise specifically indicated. References generally to section 483 are to that section as enacted in 1964, which is as it existed in 1980 when the transactions at issue occurred.

Section 483 enacted in 1964 was the first provision to adopt a "safe harbor" rate against which all deferred payment obligations were tested. In the years involved in this case, the "safe harbor" rate for installment sales transactions was 6%. If a deferred payment obligation bore a stated rate of at least 6%, the inquiry stopped and the note was deemed to have a present value equal to its face amount. On the other hand, if the deferred payment obligation did not state interest at a rate of at least 6%, section 483 used an imputed rate of 7% to calculate both the unstated interest and the deemed present value of the obligation. The deemed present value of a deferred payment obligation is referred to as the "issue price". With the enactment of sections 1271-1274 and 7872 in 1984, the fixed "safe harbor" rate in section 483 [except section 483(e)] was replaced by the Applicable Federal Rate (or "AFR"), which is adjusted monthly, but the underlying concept is identical to the original section 483 as it existed in 1980.

Because of the gap between the "safe harbor" rate and prevailing market rates, the IRS contended that a gift had been made by Taxpayers to the Trusts. The IRS did not question the principal amounts (issue prices) of the Notes for income tax purposes, which were stipulated. The IRS concluded that the Taxpayers were not entitled to rely on the 6% "safe harbor" rate in section 483, however, for gift tax purposes, and instead applied an annual discount rate of 11.5%, which it believed was the prevailing market rate. The parties stipulated before the District Court that 11.5% was the prevailing market interest rate. Discounting the face amount of the Notes at an interest rate of 11.5% reduced the present value of the Notes to $4,601,551, or $3,352,489 less than their aggregate principal amount. The IRS characterized this $3,352,489 difference as a gift to the Trusts pursuant to section 2512(b).

Taxpayers consented to having the alleged gift considered as having been made one-half by Appellant Lynn N. Schusterman and one-half by Appellant Charles Schusterman. Taxpayers each filed gift tax returns and paid to the IRS the gift tax as assessed by the IRS for the quarter ending September 30, 1980, in the amount of $528,043.61, plus interest thereon in the amount of $578,563.86, and each timely filed a proper claim for refund of the tax and interest paid by them, plus statutory interest thereon as allowed by law.

On cross motions for summary judgment, the District Court held in favor of Respondent. The heart of the Tenth Circuit's opinion affirming the District Court is contained in the following excerpts:

> Examining the plain language of the statute and giving effect to its meaning, *Johns*, 1995 WL 365142, at 8, we find that §483 establishes, for purposes of the entire tax code, whether payments under an installment sales contact contain interest hidden as principal. The text of §483 is clear —

payments under a contract for sale or exchange of property that pay interest at less than the safe harbor rate contain "total unstated interest." I.R.C. §483(c). Contract payments containing "total unstated interest" are subject to §483(a). *Id.* Section 483(a) operates via a ratio-based formula to designate a portion of each contract payment as interest. *Id.* §483(a). Unless a contract for sale or exchange of property charges sufficient interest (the safe harbor rate), I.R.C. §483(a) imputes additional interest to the contract. *Id.* Section 483, therefore, prevents taxpayers from hiding interest (taxed as income) as principal (taxed as capital gains).

Contrary to Taxpayers' arguments, I.R.C. §483 does not state that the interest rate referenced in §483(c) and specified in Treas. Reg. §483-1(d)(1)(ii)(B) shall be deemed sufficient for purposes of all other sections of the tax code. The safe harbor interest rate only prevents the IRS from using §483(a) to manipulate the ratio of principal to interest in each contract payment. Thus, we agree with the Eighth Circuit that "section [483] merely characterizes payments a principal or interest, while gift tax valuation is concerned with the value of all payments, whether of principal or interest." *Krabbenhoft*, 939 F.2d at 532 (quoting 94 T.C. at 890).

Consequently, although the safe harbor rate insulates a taxpayer from the adverse income tax effects of §483(a), we find nothing in §483 that indicates that the safe harbor rate insulates a taxpayer from the adverse gift tax effects of §2512. We therefore reject Taxpayers' contention that the language "[f]or purposes of this title" means that the IRS may not determine that a sales contract bears insufficient interest for gift tax purposes if the contract bears interest at the safe harbor rate. We conclude that §483 does not determine the interest rate at which the IRS must value an installment sales contract for gift tax purposes under §2512.

In essence, the Court of Appeals adopted the rationale of the Eighth Circuit in *Krabbenhoft v. Commissioner*, 939 F.2d 529 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 967 (1992).

In sharp contrast, in a case involving the identical legal issues, the Seventh Circuit held that the 6% "safe harbor" rate specified in section 483 applied for all purposes of the Code, and that the IRS could not use another interest rate to impute a gift under section 2512. See *Ballard v. Commissioner*, 854 F.2d 185, at 188 (7th Cir. 1988), wherein the court said —

> No review of legislative history is necessary as the language of §483 is clear. Section 483 and its "safe harbor" provision, by its very terms, is applicable to all portions of the Code. According to the tax court's own decisions, a statute's legislative history may be used to interpret the statute only if: (1) the wording is ambiguous; or (2) the wording is clear but nonetheless completely at variance with the statute's purpose, as articulated in the legislative history [citations omitted].
>
> Although we certainly understand why, in this case, the Commissioner would want to draw a distinction between rates used for income tax purposes and for valuation of gifts for gift tax purposes, such a distinction simply cannot be found in the language of §483.
>
> Even if we were to look to legislative history, there is nothing in that history which states or suggests that §483 does not apply to gift taxes. Thus, it does not appear that the application of §483 to the gift tax provisions circumvents the purpose of that provision and no further review of legislative history is necessary.

Thus, the issue between the Taxpayers and Respondent is clearly joined, and we respectfully submit the reasons why we believe the writ of certiorari should be granted.

I. REASONS WHY THE WRIT OF CERTIORARI SHOULD BE GRANTED.

Every so often a tax case comes along that is so perverse in its conclusion, so potentially pervasive in its effect, and may create such mischief for whatever is left of symmetry in the Internal Revenue Code, that the Justices have been convinced to grant the writ. We respectfully submit that this is just such a case, and we urge the Court to grant the writ. Contrary to what Respondent has claimed in opposing certiorari in *Krabbenhoft*, this is not just a gift tax case transfixed in time that has no current significance except to these Taxpayers. This case involves important and continuing issues of statutory interpretation that could trap countless unsuspecting taxpayers and subvert the will of Congress.

A. THERE IS A DIRECT CONFLICT AMONG THE COURTS OF APPEAL. THE EXISTENCE OF THE CONFLICT CREATES WIDESPREAD AND IMPORTANT UNCERTAINTY ABOUT THE MEANING OF A KEY PHRASE THAT CONGRESS HAS FREQUENTLY USED TO BRING ORDER TO THE FRAMEWORK OF THE TAX LAW.

The decision by the Tenth Circuit below and the Eighth Circuit in *Krabbenhoft* are squarely in conflict with the decision of the Seventh Circuit in *Ballard*. There are no meaningful factual differences or nuances in rationale that permit the cases to be reconciled. To the contrary, each of the cases stated that the court's conclusion was clear from the face of the statute. Surely, one interpretation is right and the other is wrong.

As we shall illustrate in greater detail in the next section of this Petition, the phrase "for purposes of this title" is one of the basic building blocks that Congress has relied on no less than 90 times to tie various provisions of U.S.C. Title 26, the Internal Revenue Code, together in a coordinated statutory framework. The deci-

sion of the Tenth Circuit means that no one seeking to understand how the tax law works can trust the plain meaning of that key phrase.

The Tenth Circuit's decision creates an ongoing issue that today and in the future may affect countless taxpayers who may rely on other "safe harbor" rate provisions in the Code only to be surprised by a claim by the IRS that is tantamount to double taxation.

We are very much aware that the Court denied certiorari in *Krabbenhoft*, but we respectfully submit that many of the issues we raise herein were not presented to the Court in the *Krabbenhoft* petition. Nor were they addressed by the Court below, in *Krabbenhoft*, or indeed in *Ballard*.[2]

The decision below represents a flagrant disregard of the Court's guidelines for statutory construction, is grossly unjust, makes the application of section 483 to sales between family members something of a lottery depending on where they reside, and results in inexorable conflicts among section 483 and other income tax provisions.

B. THE TENTH CIRCUIT'S DECISION PAYS LIP SERVICE TO THE COURT'S STANDARDS FOR STATUTORY CONSTRUCTION, BUT FLAGRANTLY IGNORES THEM. THE WORDS "*FOR PURPOSES OF THIS TITLE*" WHICH OPEN SECTION 483 ARE FUNDAMENTAL TO UNDERSTANDING HOW THE CODE WORKS. THEY CANNOT, AND SHOULD NOT, HAVE ANY MEANING OTHER THAN THAT SECTION 483 AP-

---

[2] Because *Ballard* held that section 483 controlled for both gift tax and income tax purposes, it was unnecessary for the court to analyze the consequences of a contrary decision.

PLIES TO THE GIFT TAX AS WELL AS THE INCOME TAX.

1. The courts must respect the unambiguous language of the statute.

At the time Taxpayers' transaction was consummated, section 483 provided a "safe harbor" interest rate of 6% for all transactions involving the sale or exchange of property. The opening language of section 483 stated (and still states) as follows:

> *For purposes of this title,* in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies. . .[Emphasis added]

By referring to "this title", Congress intended that the section would apply to the entire U.S.C. Title 26 (the Code), which encompasses both the income tax provisions of subtitle A and the estate and gift tax provisions of subtitle B. See *Perrin v. United States,* 444 U.S. 37, 42 (1979) (words to be given ordinary meaning unless intent to contrary shown).

According to a Lexis search, the language, "for purposes of this title", is used in at least 90 sections of the Code. Furthermore, Congress has included the distinct and more limiting language of "for purposes of this subtitle" in approximately 75 other provisions of the Code. Many other sections have no prefatory language at all. Therefore, it is clear that Congress knows and uses the distinction between the terms "title" and "subtitle". Had Congress intended to limit the scope of section 483 only to the income tax contained in subtitle A, it would have used the "subtitle" designation or no designation at all.

Congress also knows precisely how to exclude the gift tax from the application of a code section when it wants to do so. That conclusion is underscored unequivocally by section 7701, the

section that defines many of the terms used throughout the Code. Section 7701(b)(1), which defines the terms "resident alien" and "nonresident alien," opens with the phrase "For purposes of this title (other than subtitle B)." Therefore, Congress knows precisely how to exclude the provisions of the gift tax, subtitle B, when that is its intention. There is no such exclusion or qualifier to the phrase "for purposes of this title" in section 483.

When a statute is unambiguous on its face, the Court has said repeatedly that the inquiry into the meaning of the statute should begin and end with its language, and a court's sole function is to enforce the statute according to its terms.[3] Indeed, the Court has been loathe to challenge the express and unambiguous language of a statute, even if the legislative history suggests that Congressional intent may have been somewhat different than the language it chose to express that intent.[4] In the case of section 483, no such legislative history exists regarding the meaning of the phrase "for purposes of this title", so those words must be taken literally. If the decision below is correct, there would seem to be little or no practical constraints on when a court is privileged to substitute its own judgment for that of the legislature.

---

[3] See *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, at 241 (1989). Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive. *Consumer Product Safety Commission v. GTE Sylvania, Inc.* 447 U.S. 102, 108 (1980); *Miller v. Commissioner*. 836 F.2d 1274, 1283 (10th Cir. 1988). Where a statute is clear on its face, unequivocal evidence of legislative purpose is required in order to override the plain meaning of the words which are used in the statute. *Huntsberry v. Commissioner*, 83 T.C. 742, 747-748 (1984).

[4] See *City of Chicago v. Environmental Defense Fund*, 114 S.Ct. 1588, 1593 (May 2, 1994) (rejecting resort to legislative history where statute is unambiguous) *Shannon v. United States*, 114 S.Ct. 2419, 2426 (June 24, 1994) (courts have no authority to enforce principle gleaned solely from the legislative history that has no statutory reference point).

2. The Tenth Circuit disregarded these rules of statutory construction.

How does the Tenth Circuit apply these rules of statutory construction? The answer is best illustrated with the court's own words. First, the court claims to agree that the words "for purposes of this title" means that section 483 applies to the entire Code:

> "We first note that we agree with the Seventh and Eighth Circuits that I.R.C. §483 applies to the entire tax code because the section begins '[f]or purposes of this title'"[5]

However, that unequivocal acknowledgment is emasculated in the very next sentence, wherein the court said —

> "***Because the Eighth Circuits's analysis [in *Krabbenhoft*] is founded on **the plain language of §483**, we agree with its conclusion that the safe harbor interest rate referenced in I.R.C. §483 (c)(1)(B) and specified in Treas. Reg. §1.483-1(d)(1)(ii)(B) is irrelevant to gift tax valuation under I.R.C. §2512 [Emphasis supplied]."[6]

What the left hand giveth the right hand taketh away! The court's acknowledgment, on the one hand, that section 483 applies to the entire "tax code", but, on the other hand, does not deal with "valuations" under the gift tax is sophistry. If section 483 does not apply to valuations under section 2512 of the gift tax it does not apply at all to the gift tax.[7] For example, the

---

[5] Schusterman v. United States, *supra* at 993.

[6] Schusterman v. United States, *supra* at 993.

[7] The gift tax is contained in Chapter 12, subtitle B of Title 26. Chapter 12 consists of Subchapters A-C, which include sections 2501-2524. Section 2512, entitled "Valuation of gifts", is the only section in subtitle B that could have any real relevance to or interrelationship with section 483.

Seventh Circuit in *Ballard* reviewed the identical language and came to a diametrically opposite conclusion:

> No review of legislative history is necessary as the language of §483 is clear. Section 483 and its "safe harbor" provision, by its very terms, is applicable to all portions of the Code.
>
> * * *
>
> Even if we were to look to legislative history, there is nothing in that history which states or suggests that §483 does not apply to gift taxes. Thus, it does not appear that the application of §483 to the gift tax provisions circumvents the purpose of that provision and no further review of the legislative history is necessary.[8]

3. Proposed Treasury Regulations adopted the Taxpayers' position.

One very significant source of concurrence with the Seventh Circuit's reading of the "plain language" of section 483 is the Treasury Department itself. On April 8, 1986, the Treasury Department published Prop. Reg. §25.2512-8 and §1.1012-2, which deal with sales or exchanges between related parties where the consideration consists in whole or in part of the buyer's promissory note. The Internal Revenue Service, acting in concert with the Treasury Department, concluded after reading the "plain language" of section 483 that the value of an installment obligation that bears interest at a rate not less than the "safe harbor" rate prescribed by section 483 shall be its issue price for both income tax purposes and gift tax purposes under section 2512. The proposed regulations have never been adopted in final form,

---

[8] See Ballard v. Commissioner, *supra* at 188.

but they have also never been withdrawn. These proposed regulations adopted the position asserted by the Taxpayers in this case.[9]

The regulation making process is one of the most deliberate and carefully implemented activities at the Internal Revenue Service and Treasury, and proposed regulations represent the considered views of some of the most astute lawyers in both agencies. Those lawyers were not seeking to establish new law; they were interpreting the law as they believed it existed in order to implement the will of Congress.[10]

The Tenth Circuit dismissed Taxpayers' reference to the 1986 proposed regulations in a footnote, as if they were relying on them as substantive authority. But that misses the point entirely. The proposed regulations demonstrate that the Treasury Department and the Internal Revenue Service themselves had read the "plain language" of section 483 to mean that the "safe harbor" interest rate controlled for both income tax and gift tax purposes. Every commentator who has written about this subject agrees with that conclusion.[11] How, one might ask, could the court below read the identical language and reach a contrary conclusion?

---

[9] The Taxpayers and the Government have stipulated that the fair market value of the stock did not exceed the face amount of the Notes received from the Trusts. If the fair market value of the property transferred does not exceed the issue price of the debt obligation, the proposed regulation states that there is no gift under section 2512. The IRS is litigating in this case a position that is in direct conflict with its own proposed regulations.

[10] See Williams, "Preparation and Promulgation of Treasury Department Regulations Under Internal Revenue Code of 1954," 8 U.S.C. Tax Institute 733, at 742 (1956). Mr. Williams was at the time he wrote this article Assistant to the Secretary of the Treasury and Head, Legal Advisory Staff.

[11] See, *e.g.*, Manning and Hesch, "Intrafamily Sales and OID Safe Harbors: Transfer Tax Anamolies" 17 Tax Management Estates, Gifts and Taxes Journal 131 (Sept. 10, 1992); Note, *The Safe Harbor*

4. The IRS merely discounted the Notes using a different interest rate in violation of the "safe harbor" mandated by section 483.

The court's statement that "section 483 merely characterizes payments as principal or interest, while gift tax valuation is concerned with the value of all payments, whether principal or interest," is an insult to traditional guidelines for statutory construction. That statement is absolutely meaningless in the context of this case because it implies that for gift tax purposes the IRS valued the Notes received by the Taxpayers for gift tax purposes in a manner different than that mandated by section 483 for income tax purposes.

All the IRS did was calculate the present value of the Notes for gift tax purposes using a different discount factor. In calculating the purported gift from the Taxpayers to the Trusts, the IRS ignored the 6% "safe harbor" rate and discounted the Notes at 11.5%. In other words, for gift tax purposes the IRS said that $3,352,489 represented unstated or foregone interest that constituted a gift to the Trusts, and that the "real" principal of the Notes (i.e., the sales price) was $4,601,551. But section 483 says unequivocally that "for purposes of this title" if a deferred payment note bears interest at the "safe harbor" rate or greater, thou shalt not discount. In other words, the 6% interest rate is deemed to be adequate for ***all*** tax purposes — for ***all*** subtitles of the Code — and the face amount of the note is deemed to be its issue price and value. A basic premise upon which the Tenth Circuit built its opinion is quicksand.

Interest Rates Under Section 483 of the Internal Revenue Code: A Gift Tax Trap, 20 Indiana L. Rev. 679 (1987); Henderson, *Using the Imputed Interest Safe Harbor for Intrafamily Installment Sales*, 74 J. Tax. No. 2, 100 (1991); Jerry Kasner, *Family Installment Sales: IRS Applies Section 7872 Interest Rates*, 55 Tax Notes No. 13, 1788 (1992).

5. Summary.

In summary, the Tenth Circuit's decision flatly ignores the unambiguous words that Congress chose to express its intent, and the court adds insult to injury by justifying its aberrant statutory construction with a transparently specious rationale. If the common phrase "for purposes of this title" is accorded so little sanctity, a basic tool that Congress has used to weave parts of the tax law together is threatened.

C. THE TENTH CIRCUIT'S DECISION RESULTS IN TAXING THE SAME TAXPAYERS WITH RESPECT TO THE *SAME* AMOUNT, IN CONNECTION WITH THE *SAME* TRANSACTION, AS GAIN UNDER THE INCOME TAX AND AS A GIFT UNDER THE GIFT TAX. IF CONGRESS HAD INTENDED SUCH A BIZARRE RESULT, IT WOULD HAVE SAID SO EXPLICITLY.

According to the Tenth Circuit's decision, the Taxpayers are taxed on gain from a sale based on a sales price of $7,954,046 received from their childrens' Trusts, and yet are treated as having made a gift of $3,352,489 to those same Trusts, which amount is already included in the gain calculated for income tax purposes. By using an 11.5% interest rate to discount the Notes, the IRS alleged, and the Tenth Circuit agreed, that there was a disguised gift represented by unstated or foregone interest in the amount of $3,352,489 on which a gift tax was assessed. But neither the Tenth Circuit nor the IRS would apply the "sales price" they used for gift tax valuation as the "sales price" under the income tax. Thus, the Taxpayers are taxed as having both a capital gain from the sale and as having made gift of the same dollars.[12]

---

[12] Sections 453 and 483 are inextricably linked. Section 453 permits taxpayers to defer the recognition of gain in connection with a sale of property where all or a portion of the consideration is the buyer's

Since the Notes received by the Taxpayers bore interest at the section 483 "safe harbor" rate, the aggregate face amount of the Notes must be the "selling price" used to calculate gain under sections 1001 and 453. Therefore, the following example illus-

---

evidence of indebtedness (*i.e.*, an "installment note"). The gain realized on the sale will be equal to the difference between the seller's basis for the property and the sales price, which is the sum of (i) payments in the year of sale, (ii) the amount of any liability assumed by the buyer, and (iii) the issue price of the buyer's installment note. Temp. Treas. Reg. §15A.453-1(b)(2)(ii). In order to determine the issue price, taxpayers and the IRS must turn to section 483.

If a taxpayer sells property in consideration of the buyer's installment note that has a stated rate of interest at least equal to the "safe harbor" rate prescribed by section 483 (*e.g.*, 6% in 1980), the "issue price" of the obligation is deemed to be its face amount. And, if there is no other consideration (*i.e.*, payments in the year of sale or debt assumed), the "issue price" is also the "sales price" for purposes of section 453. The amount of realized gain and the "gross profit ratio" may then be calculated in accordance with section 453. See, Temp. Treas. Reg. 15A-453-1(c)(2)(ii); Treas. Reg. § 1.453-1(b)(2).

In other words, the principal amount of the installment note and therefore the "selling price" for purposes of section 453 are reduced to the extent that there is unstated interest under section 483. Conversely, if there is no unstated interest because the installment note specified interest at a rate equal to or greater than the "safe harbor" rate in section 483, the face amount of the installment note is the "selling price" under section 453.

trates the inconsistent and unresolved conflict resulting from the Tenth Circuit's decision:

	Using Sales Price Mandated by §483 Rate of 6%	Using Sales Price Computed by Discounting at Assumed Gift Tax rate of 11.5%	Difference (Equal to Amount of Alleged Gift)
Issue Price of Installment Notes ...	$7,954,046	$7,954,046	-0-
Sales Price	$7,954,046	$4,601,557	$3,352,489
Taxpayer's Basis	(223,253)	(223,253)	
Resulting Gain (or Alleged Gift)	$7,730,793	$4,378,304	$3,352,489

Therefore, as we pointed out above, the Tenth Circuit's decision imposes a tax on the ***same*** taxpayers on the ***same*** amount in connection with the ***same*** transaction under both the income tax and the gift tax. Furthermore, although the Taxpayers are charged with both capital gain and a gift, the Trusts are denied an interest deduction for the alleged foregone interest that the IRS said the Notes contained. Under the court's interpretation, the combined tax obviously exceeds the maximum rate of either the income tax or the gift tax. In some circumstances, the amount of double tax could approach the total value of the property that was the subject of the installment sale. No taxpayer would have entered into the transaction here at issue if they knew such tax results would occur.

The paradox of double taxation is created, of course, because two different interest rates are imposed with respect to the same sales transaction — one interest rate for income tax purposes and a different interest rate for gift tax purposes — with the inevitable consequence of creating two sales prices. We are not suggesting that Congress could not, if it so intended, impose both an income tax and a gift tax on the same consideration, but if indeed it intended such a draconian consequence there would have been something in the statute or the legislative history that would have said so explicitly.

We respectfully urge the Court to reexamine this issue by granting the writ of certiorari.

D. THE TENTH CIRCUIT'S DECISION DECIMATES SECTION 483(e), SUBVERTS THE WILL OF CONGRESS TO PROTECT INTRA-FAMILY SALES OF LAND, AND REPRESENTS A CONTINUING THREAT TO COUNTLESS TAXPAYERS TODAY AND IN THE FUTURE.

Intra-family sales of farmland, a homesite, or the like are an everyday occurrence and an important tool in preserving property for the family. Section 483(g) [subsequently renumbered section 483(e)] was enacted in 1981 as an exception to protect intra-family sales of farmland at a time when the "safe harbor" rate under the general provisions of section 483(a) was being raised to a level that might have compelled families that wished to preserve their farm heritage either to engage in heavily taxed transactions or sell to third parties.[13] The legislative history of section 483(e) clearly indicates that Congress did not want to impose undue tax burdens on intra-family sales of farmland, whether that tax burden took the form of an income tax or a gift tax.[14] To hold otherwise would be to conclude that Congress was willing to lay a trap for the very people it was trying to protect.

---

[13] Based upon its legislative history, section 483(g) was enacted solely in response to Treasury regulations that, effective July 1, 1981, (i) increased the section 483(a) safe harbor rate from 6% to 9%, and (ii) increased the section 483(a) imputed rate from 7% to 10%. Thus, at a time when market rates of interest were approaching the high teens, the Treasury Department raised the section 483(a) safe harbor rate from 6% to *only* 9%. T.D. 7781, 46 F.R. 34569 (July 2, 1981).

[14] The floor debate sent a strong warning to the IRS that taxpayers are entitled to use the section 483(e) rate in intra-family obligations without adverse tax consequences. For example, during the Senate floor debate, Senator Roger Jepsen stated as follows:

The "safe harbor" rate specified today for section 483(e) is 6%. Therefore, let us suppose that **today** the Taxpayers sell to their childrens' Trusts farmland having a fair market value of $500,000, and receive in consideration therefore installment notes stating interest at 6%. For income tax purposes the face amount of the promissory notes would clearly be deemed to be their issue price, and there would be no reallocation between principal and unstated interest (because there would be no unstated interest). This would be true even if the AFR at the time is 9%. However, under the Tenth Circuit's decision the IRS could assess a gift tax based upon the difference between $500,000 and the present value of the Notes discounted at whatever might be determined to be a current prevailing market rate of interest (or at least at the AFR). That not only engenders the double gift and income taxation about which we have complained, but it clearly subverts the very purpose of section 483(e). Since the combined income and gift taxes will be onerous, the related parties are forced either to abandon the "safe harbor" rate of interest because a higher rate will result in less overall tax, or, alternatively, abandon entirely the intra-family sale. Either course conflicts with both the statutory language and the clear Congressional intent.

There is no conceptual difference between the general "safe harbor" rate in section 483(a) and the more targeted "safe harbor" rate in section 483(e). They serve the identical function, and there is nothing in the language of section 483(e) that

---

> The new regulations issued by the Treasury (raising the safe harbor rate) strike at the very heart of the venerable tradition (of parents leaving businesses to their children)... So, a father and mother give the child a break: a low interest loan and a deferred payment schedule. ***This does two things: It helps the young person when such help is critical and allows parents to pass on their property to their offspring without incurring the confiscatory rates of present estate taxation.*** Raising the imputed interest rates will effectively close off that option to many farmers and business men. 127 Cong. Rec. 17806 (July 28, 1981) [Emphasis supplied].

expressly expands its application to section 2512 under the gift tax. To the contrary, any taxpayer that relies on section 483(e) is relying on the opening words of section 483 that it applies for "purposes of this title". The threat that the IRS might attack the "safe harbor" under section 483(e) is not idle; to the contrary, the threat has already materialized.[15]

Frazee v. Commissioner[16] involved a sale of California real property in 1985 from the taxpayers to their children in exchange for certain promissory notes bearing interest at a rate of 7% per annum. The taxpayers contended that the promissory notes had a value equal to their face amount, since the interest rate satisfied the "safe harbor" rate specified at the time in section 483(e). The Commissioner countered that neither section 483(a) nor 483(e) had any application to the gift tax, and that the fair market value of the promissory notes should be determined with reference to the AFR prescribed by section 7872 or, alternatively, by reference to an economic prevailing interest rate. The Tax Court reaffirmed its previous decisions in *Ballard* and *Krabbenhoft* that section 483 was irrelevant for purposes of the gift tax (both of which cases involved facts that pre-dated the enactment of section 483(e), 1274 and 7872), which left the court free to deal with section 7872 on its own. The court acknowledged that section 7872 applied for purposes of both the income tax and the gift tax, and held that the gift portion in a part-sale, part-gift of property transaction could be governed by section 7872. Since the Commissioner had urged as her primary position that the AFR be used as the discount rate under section 7872, which was considered to be more favorable to the taxpayer than a true market rate,

---

[15] Since the seller will not likely file a protective gift tax return, the statute of limitations will never run on the power of the IRS to claim that a gift was made in the year of sale.

[16] *Frazee v. Commissioner*, 96 T.C. 554 (1992)

the Tax Court adopted that discount rate in calculating the imputed gift and gift tax.

The Tax Court was wrong, not only because of its conclusion that neither section 483(a) nor section 483(e) applies to valuations under the gift tax, but also because it extended section 7872 to a sale transaction notwithstanding the express statutory language to the contrary. Section 7872(f)(8) explicitly excludes sales or exchanges from the operation of section 7872, which transactions are governed by the more specific provisions of section 483 and 1274. What does section 7872(f)(8) mean if not what it says? Congress never intended section 7872 to apply to sales or exchanges of property between related parties, even those that may involve a part gift, because those transactions are covered by sections 483 and 1274.[17] The Tax Court only applied section 7872 because it insisted on a continued misreading of section 483.

Moreover, the Tax Court acknowledged that section 7872 applied for both income tax and gift tax purposes, but it never tried to reconcile that conclusion with the actual results of the case. Since the taxpayers had satisfied the "safe harbor" rate in section 483(e), there could be no imputed interest for income tax purposes, either as income to the seller or as an interest deduction for the buyer, and the face amount of the note would be the sales price for income tax purposes. Nevertheless, the IRS took the position that a higher interest rate, and therefore a lower sales price, must be used for gift tax purposes. But when section 7872

---

[17] See Staff of Joint Committee on Taxation, 99th Cong., 1st Sess. (Comm. Print April 23, 1985), at 12, "Description of the Tax Treatment of Imputed Interest on Deferred Payment Sales of Property," wherein it is stated:

"It is possible that some transactions may literally fall within the scope of both sections 1274 or 483 and section 7872. Under present law, if a transaction is subject to section 1274 or section 483, section 7872 does not apply. [citing section 7872(f)(8)]."

deals with the gift tax aspects of a below market loan, it explicitly deals with the income tax aspects as well. Therefore, in addition to having made a gift, the taxpayer would be deemed to receive interest income in the amount of the gift and his children would get an interest deduction for the same amount. However, that result is contrary to the mandate of section 483(e), which demonstrates that section 7872 and section 483(e) cannot apply to the same transaction. The conflict inherent in trying to apply two different interest rates to the same transaction is so apparent that one is left bewildered at the decision.

The result of the Tenth Circuit's decision in this case, coupled with the decision of the Tax Court in *Frazee*, means that the "safe harbor" protected by section 483(e) has also effectively been read out of the Code.[18] This result subverts the will of Congress, and an untold number of taxpayers are at risk unless this Court grants certiorari here and corrects these errors.

E. THE TENTH CIRCUIT'S REJECTION OF BASIC TIME-VALUE-OF-MONEY CONCEPTS ENACTED BY CONGRESS TO GOVERN A VARIETY OF DEFERRED PAYMENT TRANSACTIONS (INCLUDING SALES AND GIFTS BETWEEN RELATED PARTIES) CREATES IRRECONCILABLE CONFLICTS ABOUT HOW THE TIME-VALUE-OF-MONEY PROVISIONS INTERACT WITH OTHER CODE SECTIONS.

If the words "for purposes of this title" in section 483 are given their ordinary meaning, whenever interest at the "safe harbor" rate is stated, the tax consequences to both sides are clear and harmonious because there is only one sales price for the transac-

---

[18] Other sections, in addition to section 483(e), prescribe "safe harbor" rates that are less than the AFR. See sections 1274(c)(3) and (4) and 1274A. All of these "safe harbors" are in jeopardy under the Tenth Circuit's decision below.

tion: (i) there is no gift; (ii) the face amount of the note is the "issue price", and the seller will calculate gain based on that price; (iii) interest on the note will be taxed as ordinary income when received; (iv) the buyer's basis for the property will be equal to the issue price of the note; and (iv) the buyer will be entitled to an interest deduction equal to the stated rate when it is paid.

Such symmetrical treatment is exactly what Congress has created in other Code sections dealing with interest rate sensitive time value of money issues. Section 7872, added to the Code in 1984 as part of a comprehensive restatement of the time-value-of-money concepts, accomplishes essentially the identical result with respect to non-sale or exchange transactions (*i.e.*, loans) between related parties by making the tax consequences to the lender and the borrower mirror reflections of each other for both income and gift tax purposes.[19]

---

[19] Pursuant to section 7872, if a loan bears interest at the AFR, there is neither a gift to the borrower nor imputed interest for income tax purposes. However, if a loan bears interest at a rate less than the AFR, the transaction is characterized as a "gift loan", and the income tax and gift tax consequences are as follows: (i) the lender/donor is deemed to have transferred the "foregone interest" to the borrower/donee as a gift in the year the loan is made, (ii) the borrower/donee is deemed to have retransferred the foregone interest to the lender/donor, which he reports as interest income when received, and (iii) the borrower/donee is entitled to an interest deduction in the same amounts that the lender/donor reports as interest income. Therefore, it is critical to the statutory scheme that a single interest rate is used for both income tax and gift tax purposes, and that the treatment of the lender/donor and the borrower/donee (the family unit) is symmetrical. Section 7872 was a direct response to the Court's decision in *Dickman v. Commissioner*, 465 U.S. 300 (1984), where the Court held that a below-market interest rate loan to a related party could result in a gift. Congress wanted to make the consequences consistent to both the donor and the donee, and it clearly knows how to do so by using the phrase "for purposes of this title."

Why, one might ask, did Congress not amend section 483 in 1984 to accomplish the same result? The logical and obvious answer is that Congress thought the issue had already been resolved by virtue of the unambiguous mandate that section 483 applied "for purposes of this title." So did the IRS and the Treasury Department when the Proposed Regulations were issued in 1986.[20] Indeed, it strains credulity to believe that Congress would insist on symmetry between lender and borrower in connection with a gift loan, while maintaining a discordant and conflicting treatment of seller and buyer in a sale or exchange transaction between related parties. Yet that is the result of the decision below.

The Tenth Circuit seems to have adopted Respondent's position that section 483 operates (i) in isolation from other provisions of the Code, and (ii) only in a negative manner. That is, the court seems to be saying that the only function of section 483 is to reallocate the face amount of a deferred payment between principal and interest if the note bears interest at less than the "safe harbor" rate. Conversely, if the note bears interest at the "safe harbor" rate, the court believes that section 483 is simply irrelevant for both income and gift tax purposes. If that is so, what in fact is the "issue price" of the note and the sales price for purposes of calculating gain realized by the seller?

The court's reasoning is inscrutable. Section 483, by its very essence, determines the "issue price" of an installment note received as consideration in a sale of property whether the interest rate is less than or equal to (or greater than) the "safe harbor" rate. If the stated interest is less than the "safe harbor" rate, the face amount of the note is adjusted to determine the "issue price". If the interest rate is equal to (or greater than) the "safe harbor" rate, the corollary is that the face amount of the note *is* the "issue price".

---

[20] Prop. Treas. Regs. §25.2512-8 and §1.1012-2, *supra* at p. 13.

The determination of the "issue price" has, in turn, a critical relationship to other income tax provisions, such as section 453 (the installment sale provision), section 1001 (determining the amount realized by the seller), section 1012 (calculating the buyer's basis for purchased property), and section 1015 (determination of basis in a part sale/part gift transaction), among others. It also has a bearing on the buyer's interest deduction. Therefore, the Tenth Circuit's decision creates irreconcilable conflicts among sections 453, 483, 1001, 1012, 1015, et seq.

The Tenth Circuit's misreading of section 483 seems to be a fundamental premise upon which its reasoning is based. If that premise fails, so must the court's conclusions.

Congress sought to bring consistency to time-value-of-money concepts in the Code. The Tenth Circuit's decision destroys that laudable objective.

II. CONCLUSION

For all of the reasons set forth above, Petitioners pray that the Court grant the Writ of Certiorari and set the case for briefing and argument on the merits.

Respectfully submitted,

*RICHARD A. FRELING
DAVID G. GLICKMAN
HOPKINS & SUTTER
1717 MAIN STREET, SUITE 3700
DALLAS, TEXAS 75201
(214) 653-2215

Of Counsel:
MICHAEL J. GRAETZ
127 WALL STREET
NEW HAVEN, CONNECTICUT 06511
(202) 432-4828

**Counsel of Record for Petitioners*

Dated: January 16, 1996

United States Court of Appeals

TENTH CIRCUIT

CHARLES SCHUSTERMAN AND LYNN N. SCHUSTERMAN, *Plaintiffs-Appellants* vs. UNITED STATES OF AMERICA, *Defendant-Appellee.* — No. 94-5106

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OKLAHOMA (D.C. No. 92-C-590-E)

Richard A. Freling, Dallas, Texas, (Donald A. Glassberg of Levenfeld, Eisenberg, Janger, Glassberg & Halper, Chicago, Illinois, Theodore A. Sinars of Madden, Jiganti, Moore & Sinars, Chicago, Illinois, David G. Glickman of Hopkins & Sutter, Dallas, Texas, with him on the brief), for Plaintiffs-Appellants.

Charles Bricken, Attorney, Department of Justice, Washington, D.C., (Loretta C. Argrett, Assistant Attorney General, Richard Farber, Attorney, Stephen Charles Lewis, United States Attorney, Of Counsel, Department of Justice, Washington, D.C., with him on the brief), for Defendant-Appellee.

Before ANDERSON, BARRETT, and BALDOCK, Circuit Judges.

BALDOCK, Circuit Judge.

Plaintiffs Charles and Lynn N. Schusterman ("Taxpayers") filed this tax refund action against Defendant United States in the district court pursuant to 28 U.S.C. § 1346(a)(1), contending the Internal Revenue Service ("IRS") erroneously assessed and col-

lected gift taxes from them. On cross motions for summary judgment, the district court entered judgment in favor of the United States. Our jurisdiction over Taxpayers' appeal arises under 28 U.S.C. § 1291.

On September 21, 1980, Taxpayers transferred 420 shares of Tilco, Inc. Class B common stock to five irrevocable trusts ("Trusts"). The Trustees of the Trusts executed promissory notes payable to Taxpayers in exchange for the Tilco stock, in the principal amount of $7,954,046.60, the undisputed fair market value of the stock. The promissory notes provided interest at six percent per annum. Taxpayers and the United States stipulated, however, that the prevailing market interest rate in September 1980 was eleven and one-half percent. Tax counsel advised Taxpayers to set the interest rate of the promissory notes at six percent — the safe harbor rate referenced in I.R.C. § 483(c) and specified in Treas. Reg. § 1.483-1(d)(1)(ii)(B) — in order to prevent the IRS from assessing gift taxes under I.R.C. § 2512(b) on the amount by which the value of the stock exceeded the value of the notes, discounted to reflect the prevailing market interest rate.

Despite Taxpayers' efforts, the IRS notified them that they owed gift taxes. The IRS determined Taxpayers owed a deficiency in gift taxes arising from the stock transfer because the promissory notes that served as consideration for the transaction did not provide the prevailing market interest rate. The IRS informed Taxpayers that use of the safe harbor interest rate under § 483 and Treas. Reg. § 1483-1(d)(1)(ii)(B) did not preclude it from imposing gift taxes pursuant to I.R.C. § 2512(b) on the amount by which the value of the stock exceeded the present value of the notes, discounted to reflect the market interest rate. The IRS concluded that Taxpayers had made a gift to the Trusts because the value of the stock exceeded the value of the promissory notes received in exchange. That is, the promissory notes Taxpayers received in consideration for the transfer bore six

percent interest, five and one-half percent less than the prevailing eleven and one-half percent market rate. Thus, the IRS disregarded the six percent rate specified in the promissory notes, and applied an annual discount rate of eleven and one-half percent. Discounting the principal amount of the promissory notes by eleven and one-half percent reduced the present value of the promissory notes to $4,601,551 which is $3,352,489 less than the $7,954,046.60 value of the stock. Pursuant to I.R.C. §§ 2501(a)(1), 2512(b), the IRS taxed the $3,352,489 difference between the present value of the promissory notes and the value of the stock as a gift by Taxpayers to the Trusts.

Taxpayers filed gift tax returns and paid gift taxes with interest in the sum of $1,157,127.72. Thereafter, Taxpayers filed claims for refund of the taxes and interest, plus statutory interest. Taxpayers argued their use of the six percent safe harbor interest rate in the notes under I.R.C. § 483 prevented the IRS from determining the present discounted value of the promissory notes using the market interest rate of eleven and one-half percent and imposing gift taxes pursuant to I.R.C. § 2512(b).

After the IRS denied their refund claim, Taxpayers filed a refund action in the district court pursuant to 28 U.S.C. § 1346(a)(1) contending the IRS had erroneously assessed and collected gift taxes. Taxpayers and the United States stipulated "[i]f the court determines that the 6% rate used by Plaintiffs is inapplicable to the stock-transfer transaction, then the 11.5% rate used by the IRS is applicable." On cross motions for summary judgment, the district court ruled that I.R.C. § 483 does not provide a safe harbor from the application of market interest rates for purposes of gift tax valuation. Consequently, the district court concluded that Taxpayers' use of the six percent I.R.C. § 483 safe harbor interest rate in the promissory notes did not prevent the IRS from discounting the value of the notes by the prevailing market rate to determine the present value of the consideration received in exchange for the stock. The district court ruled that

under I.R.C. §§ 2501(a)(1), 2512(b) the IRS was authorized to determine the present discounted value of the promissory notes using the eleven and one-half percent prevailing market interest rate, and impose gift taxes on the $3,352,489 difference between the $7,954,046.60 value of the stock and the $4,601,551 discounted value of the promissory notes. In sum, the district court held that I.R.C. § 483 "is irrelevant to a 26 U.S.C. § 2512 valuation of gifts" and entered summary judgment in favor of the United States. This appeal followed.

On appeal, Taxpayers contend the district court erred by ruling that § 483 is not relevant to a § 2512 valuation of an installment sales contract for purposes of gift tax liability. Specifically, Taxpayers argue that their use of the six percent safe harbor rate under I.R.C. § 483 prevents the IRS from using the prevailing market interest rate to determine the discounted present value of the promissory notes under § 2512(b).

I

Taxpayers, argument on appeal requires us to interpret I.R.C. § 483 and I.R.C. § 2512. In statutory interpretation we look to the plain language of the statute and give effect to its meaning. *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989); *Johns v. Stewart*, F.3d , No. 94-4161, 1995 WL 365142, at *8 (10th Cir. June 20, 1995). " 'Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.' " *Kaiser Aluminum & Chem. Co. v. Bonrorno*, 110 S. Ct. 1570, 1575 (1990) (quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). If the statute is clear, that is the end of our inquiry. *United States v. Morgan*, 922 F.2d 1495, 1496 (10th Cir.), *cert. denied*, 501 U.S. 1207 (1991). We review the district court's interpretation of a federal statute de novo. *Eastern Inv. Corp. v. United States*, 49 F.3d 651, 657 (10th Cir. 1995). We review the district court's entry of summary judgment de

novo, applying the same legal standard used by the district court under Fed. R. Civ. P. 56(c). *State of Utah v. Babbitt*, 53 F.3d 1145, 1148 (10th Cir. 1995).

A.

The version of I.R.C. § 483 in effect when Taxpayers transferred the stock to the irrevocable trusts provided:

Sec. 483. INTEREST ON CERTAIN DEFERRED PAYMENTS.

(a) *Amount Constituting Interest.* — For purposes of this title, in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which this section applies which are due under such contract.

(b) *Total Unstated Interest.* — For purposes of this section, the term "total unstated interest" means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of —

(1) the sum of the payments to which this section applies which are due under the contract, over

(2) the sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of paragraph (2), the present value of a payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary . . . .

(c) *Payments to Which Section Applies.* —

(1) *In general.* — Except as provided in subsection (f), this section shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract —

(A) under which some or all of the payments are due more than one year after the date of such sale or exchange, and

(B) under which, using a rate provided by regulations prescribed by the Secretary for purposes of this subparagraph, there is a total unstated interest.

Any rate prescribed for determining whether there is total unstated interest for purposes of subparagraph (B) shall be at least one percentage point lower than the rate prescribed for purposes of subsection (b)(2).

26 U.S.C. § 483 (1976 ed.). We may determine the clear intent of Congress in enacting I.R.C. § 483 by explicating the individual sections which together comprise the whole. *See Ron Pair Enter., Inc.*, 489 U.S. at 241.

Section 483(c) defines the scope of I.R.C. § 483. Section 483(c) provides that § 483 applies to payments under a contract for sale or exchange of property due more than six months after the sale if the contract: (1) provides for any payment more than one year after the date of the sale, and (2) the payments contain "total unstated interest" "using a rate provided by regulations." I.R.C. § 483(c)(1). In addition to the time constraints, § 483(c)(1)(B) clearly establishes that § 483 applies only to payments under a contract for sale or exchange of property that contain "total unstated interest" when compared to an interest rate prescribed by regulation. *Id.; see* Treas. Reg.

§ 1.483-1(d)(1)(ii)(B) (providing six percent interest rate at time of transaction in instant case).[1]

The concept of "total unstated interest" therefore constrains the scope of § 483. Section 483(b) sets forth a formula to calculate whether a contract for sales or exchange contains "total unstated interest." I.R.C. § 483(b). Implicit in the subsection is the truism that a payment will never contain "total unstated interest" if the contract provides interest at least at the level prescribed by the regulation referenced in § 483(b), (c)(1)(B) — *i.e.*, the safe harbor rate. *See* I.R.C. § 483(b), (c)(1)(B); Treas. Reg. § 1.483-1(d)(1)(ii)(B). The interest rate set by regulation is known as the "safe harbor" rate because a contract for the sale or exchange of property that employs the interest rate will by definition never contain "total unstated interest." Because the plain language of § 483(c)(1)(B) establishes that contract payments that do not contain "total unstated interest" are outside the scope of I.R.C. § 483, the interest rate set by regulation carves out a safe harbor from application of I.R.C. § 483(a) itself. Thus, at the time of the transaction in the instant case, a contract for sale or exchange of property that provided interest on deferred payments at a rate at least equal to the six percent safe harbor rate set by Treas. Reg. § 1.483-1(d)(1)(ii)(B) was not subjected to I.R.C. § 483(a).

A contract for sale or exchange of property that fails to provide interest at least at the minimum safe harbor rate is subject to § 483(a) because the payments contain "total unstated interest." I.R.C. § 483(c). The title of § 483(a) — "Amount Constituting Interest" — announces the intent and effect of the section. Simply put, § 483(a) designates what amount of principal in each

---

[1] Treas. Reg. § 1.483-(d)(1)(ii)(B) provides: "[f]or payments on account of a sale or exchange of property entered into on or after July 24, 1975, and before July 1, 1981 . . . the test rate prescribed by . . . this section shall be 6 percent per annum simple interest."

payment containing insufficient interest will be taxed as interest. I.R.C. § 483(a). Under the precise language of § 483(a), for purposes of the entire tax code, payments under any contract for the sale or exchange of property that contain total unstated interest as defined in § 483(b), (c) will be subjected to a ratio-based computation to determine what portion of each payment will be recharacterized as interest and taxed accordingly. I.R.C. § 483(a).

We believe a careful examination of the plain language of the statute reveals Congress' clear intent in enacting § 483. Section 483 insures that a taxpayer does not avoid income taxes by structuring an installment contract to provide only for the payment of principal (taxed as capital gains) without interest (taxed as ordinary income). Unless payments under an installment contract provide interest at a minimum rate (the safe harbor interest rate), the payments are deemed under operation of § 483(b), (c) to contain "total unstated interest." Under § 483(a), payments that contain "total unstated interest" are manipulated via a ratio-based formula to recharacterize a portion of the principal as interest — *i.e.,* to impute a higher interest rate to the contract when insufficient interest was provided in the contract. In sum, I.R.C. § 483 prevents a seller of property under an installment contract for sale or exchange of property from converting ordinary income (interest) into capital gains (principal).

B.

In contrast, I.R.C. § 2501(a)(1) imposes a tax on property transferred by gift. *See* I.R.C. § 2501(a)(1) ("A tax . . . is hereby imposed . . . on the transfer of property by gift."). Section 2512(a) provides: "[i]f the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift." I.R.C. § 2512(a). Section 2512(b) of the tax code provides that: "[w]here property is transferred for less than an

adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift." I.R.C. § 2512(b). Consequently, under I.R.C. §§ 2501(a)(1), 2512(b), the IRS assesses a gift tax when the value of property transferred exceeds the value of the consideration received. *See generally Commissioner v. Wemyss,* 324 U.S. 303, 306 (1945) (observing that IRS may tax as a gift the difference in value between property transferred and inadequate consideration received in return). Under settled precedent, the IRS may determine for gift tax valuation purposes the amount by which the fair market value of property exceeds the value of an installment sales contract by examining the face value of the contract, the interest rate, the prevailing market interest rate, and the length of the contract. *E.g., Blackburn v. Commissioner,* 20 T.C. 204, 207 (1953). Pursuant to §§ 2501, 2512 the IRS may impose a gift tax when the value of property transferred by a taxpayer exceeds the present value of a promissory note that bears a below market interest rate. *Id.* at 206-07.

C.

The conflict in the instant case presents a narrow issue based upon the tax code sections summarized above. A taxpayer who uses the safe harbor interest rate in an installment sales contract prevents the IRS from applying § 483(a) to recharacterize portions of payments as interest. We must decide, however, whether the safe harbor interest rate prevents the IRS from discounting the present value of the same sales contract to reflect the higher prevailing market interest rate for gift tax valuation purposes.[2] Taxpayers urge that we answer in the affirmative.

---

[2] We note that Taxpayers and the United States stipulated that the $7,954,046.60 face value of the promissory notes equaled the fair market value of the stock transferred. Consequently, the only dispute concerns the interest rate used in the transaction.

The two circuits that have addressed this issue are in conflict. In *Ballard v. Commissioner,* 854 F.2d 185 (7th Cir. 1988), the Seventh Circuit ruled that an installment sales contract that provided interest at the safe harbor rate was immune from operation of both § 483(a) and § 2512(b). The taxpayer in *Ballard* sold the family farm to her children under a contract bearing interest at the six percent safe harbor rate. The prevailing market interest rate, however, was eighteen percent. The IRS notified the taxpayer that she owed gift taxes because the value of the farm exceeded the present value of the contract, discounted by the prevailing market interest rate. *Ballard,* 854 F.2d at 186-87.

The taxpayer appealed the notice of the deficiency to the United States Tax Court, arguing that I.R.C. § 483 provided a safe harbor that permitted her to charge a six percent interest rate on an installment sales contract without suffering adverse income or gift tax consequences. The taxpayer contended that the introductory language of § 483(a) states that it applies to all provisions of the tax code, including by definition the gift tax provisions. Because § 483(a) applies to all provisions of the code, the taxpayer maintained that by using the six percent safe harbor rate in an installment sales contract, she prevented the IRS from using the prevailing eighteen percent market rate to determine the present value of the installment contract for gift tax purposes. The tax court affirmed the IRS' use of the eighteen percent market rate to determine the present discounted value of the sales contract, and held that § 483 was irrelevant to gift tax valuation. *Id.* at 187.

On appeal, the Seventh Circuit reversed the Tax Court and ruled that I.R.C. § 483 applied to all provisions of the tax code, including income and gift tax provisions. *Id.* at 188-89. Further, the court observed that neither the plain language of I.R.C. § 483 nor the legislative history suggested that the provision did not apply to gift taxes. *Id.* at 188. Without identifying the precise

statutory support for its ruling, the court concluded that the taxpayer's use of the I.R.C. § 483 safe harbor interest rate precluded the IRS from using the eighteen percent market rate to discount the present value of the installment contract for gift tax purposes. *Id.* at 189. Under the Seventh Circuit's ruling in *Ballard*, therefore, in addition to providing a safe harbor from operation of § 483(a), the six percent interest rate constitutes a safe harbor from imposition of gift taxes under § 2512(b) as well.

In *Krabbenhoft v. Commissioner*, 939 F.2d 529 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 967 (1992), the Eighth Circuit rejected the Seventh Circuit's reasoning in *Ballard* and ruled that I.R.C. § 483 is irrelevant to the valuation of an installment sales contract for gift tax purposes. The taxpayers in *Krabbenhoft* sold the family farm to their sons by means of a contract for deed payable at the six percent safe harbor rate. The prevailing market interest rate, however, was eleven percent. The IRS notified the taxpayers that they owed a deficiency in gift taxes on the amount by which the value of the farm exceeded the present value of the contract for deed discounted by the prevailing market rate of eleven percent. *Krabbenhoft*, 939 F.2d at 530.

The taxpayers petitioned the United States Tax Court for review, arguing that because § 483(a) states it applies "[f]or purposes of this title," the IRS may not determine that the contractual interest was insufficient for gift tax purposes when the interest (the safe harbor rate) was sufficient for purposes of § 483. The tax court upheld the gift tax assessment, *Krabbenhoft v. Commissioner*, 94 T.C. 887 (1990), *aff'd*, 939 F.2d 529 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 967 (1992), and the taxpayers appealed.

On appeal, the Eighth Circuit ruled that because § 483 was irrelevant to the valuation of an installment sales contract for gift tax purposes, § 483 does not control the interest rate at which the IRS must determine the present value of an installment sales contract. *Krabbenhoft*, 939 F.2d at 533. The court initially ob-

served that § 483 applies to the entire tax code because the section begins "[f]or purposes of this title." The Eighth Circuit noted, however, that the fact that § 483 applies to the entire tax code does not make the section relevant to § 2512(b). "The flaw in this argument is the assumption that § 483 is relevant to the determination of present value for gift tax purposes." *Id.* at 532. In its analysis, the Eighth Circuit quoted the tax court's opinion from which the taxpayers appealed:

> We agree that the prefatory language of section 483 is unambiguous, and that section 483 therefore applies to all sections of the Code to which it is relevant. However, we find nothing in the language of section 483 that indicates that this section has anything to do with valuation. The section merely characterizes payments as principal or interest, while gift tax valuation is concerned with the value of all payments, whether of principal or of interest. The character of a payment does not affect its value for gift tax purposes.

Id. (quoting *Krabbenhoft*, 94 T.C. at 890). Because the character of a payment under I.R.C. § 483 — *i.e.*, principal or interest — does not affect the overall value of the obligation for gift tax purposes under I.R.C. § 2512, the Eighth Circuit held that "§ 483 is not relevant to the gift tax statute." *Id.* Instead, the court explained that use of the I.R.C. § 483 safe harbor interest rate in an installment contract prevents the IRS from recharacterizing certain payments as principal or interest and protects the taxpayers from adverse income tax liability, but does not protect taxpayers from adverse gift tax liability by preventing the IRS from employing the prevailing market rate of interest to discount the present value of the contract for gift tax purposes. *Id.* at 532-33. Consequently, the Eighth Circuit rejected *Ballard* and held that "§ 483 does not limit the interest rate the Commissioner can use in valuing an installment contract for gift tax purposes because § 483 is simply irrelevant to such a determination." *Id.* at 533.

II.

In the instant appeal, Taxpayers argue that we should follow the Seventh Circuit's reasoning in *Ballard* and reject the Eighth Circuit's analysis in *Krabbenhoft*. Taxpayers essentially contend that because § 483(a) applies "[f]or purposes of this title," the IRS may not determine that interest sufficient for § 483 is insufficient for gift tax purposes. Taxpayers maintain that § 483 operates to prevent the IRS from imputing additional interest to a sales contract under any section of the tax code if the contract provides interest at the minimum safe harbor level under § 483. Because the promissory notes used as consideration for the stock transfer in the instant case bore interest at the six percent safe harbor rate, Taxpayers contend we should reverse the district court and remand with instructions to enter summary judgment in favor of Taxpayers.

We first note that we agree with the Seventh and Eighth Circuits that I.R.C. § 483 applies to the entire tax code because the section begins "[f]or purposes of this title." I.R.C. § 483(a); *see also Krabbenhoft*, 939 F.2d at 532; *Ballard*, 854 F.2d at 188-89. Because the Eighth Circuit's analysis is founded on the plain language of § 483, we agree with its conclusion that the safe harbor interest rate referenced in I.R.C. § 483(c)(1)(B) and specified in Treas. Reg. § 1.483-1(d)(1)(ii)(B) is irrelevant to gift tax valuation under I.R.C. § 2512. *See Krabbenhoft*, 939 F.2d at 532-33. We therefore decline to adopt the Seventh Circuit's interpretation that § 483 limits the interest rate the IRS may use in valuing an installment sales contract for gift tax purposes. *See Ballard*, 854 F.2d at 188-89.

Examining the plain language of the statute and giving effect to its meaning, *Johns*, 1995 WL 365142, at *8, we find that § 483 establishes, for purposes of the entire tax code, whether payments under an installment sales contract contain interest hidden as principal. The text of § 483 is clear — payments under a contract for sale or exchange of property that pay interest at less than the

safe harbor rate contain "total unstated interest." I.R.C. § 483(c). Contract payments containing "total unstated interest" are subject to § 483(a). *Id.* Section 483(a) operates via a ratio-based formula to designate a portion of each contract payment as interest. *Id.* § 483(a). Unless a contract for sale or exchange of property charges sufficient interest (the safe harbor rate), I.R.C. § 483(a) imputes additional interest to the contract. *Id.* Section 483, therefore, prevents taxpayers from hiding interest (taxed as income) as principal (taxed as capital gains).

Contrary to Taxpayers' arguments, I.R.C. § 483 does not state that the interest rate referenced in § 483(c) and specified in Treas. Reg. § 1.483-1(d)(1)(ii)(B) shall be deemed sufficient for purposes of all other sections of the tax code. The safe harbor interest rate only prevents the IRS from using § 483(a) to manipulate the ratio of principal to interest in each contract payment. Thus, we agree with the Eighth Circuit that "'section [483] merely characterizes payments as principal or interest, while gift tax valuation is concerned with the value of all payments, whether of principal or interest." *Krabbenhoft*, 939 F.2d at 532 (quoting 94 T.C. at 890).

Consequently, although the safe harbor rate insulates a taxpayer from the adverse income tax effects of § 483(a), we find nothing in § 483 that indicates that the safe harbor rate insulates a taxpayer from the adverse gift tax effects of § 2512. We therefore reject Taxpayers' contention that the language "[f] or purposes of this title" means that the IRS may not determine that a sales contract bears insufficient interest for gift tax purposes if the contract bears interest at the safe harbor rate. We conclude that § 483 does not determine the interest rate at which the IRS must value an installment sales contract for gift tax purposes under § 2512.[3] *See Krabbenhoft*, 939 F.2d at 533 ("[Section] 483 does

---

[3] Taxpayers support their argument with regulations proposed by the IRS nearly a decade ago which have never been adopted, and

not limit the interest rate the Commissioner can use in valuing an installment sales contract for gift tax purposes because § 483 is simply irrelevant to such a determination.")

We examine the transaction in the instant case informed by our interpretation of § 483. Taxpayers transferred stock to the Trusts in exchange for promissory notes payable at the six percent safe harbor rate. By so doing, Taxpayers insulated themselves from adverse income tax consequences under § 483(a). That is, because the notes bore interest at the safe harbor rate referenced in § 483(c), the IRS may not employ § 483(a) to designate a portion of the principal as interest. *See* I.R.C. § 483(a), (c). For purposes of the entire tax code, therefore, the notes do not contain interest hidden as principal. *Id.*

Section 483, however, does not establish the value of the notes for gift tax purposes. Instead, settled gift tax provisions control this determination. Section 2512(b) provides that "[w]here property is transferred for less than an adequate and full consideration in money . . . the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift." Because the notes bore interest below the market rate, the present value of the notes was less than the principal amount. Under § 2512(b), therefore, Taxpayers made a gift to the trusts consisting of the difference between the value of the stock and the

---

commentary published in professional journals. See Prop. Treas. Reg. §§ 25.2512-8, 1.1012-2(b), 1.483-2, 1.483-4(b)(2)(ii), 51 Fed. Reg. 12022, 12037-40, 12098 (1986); Elliott Manning & Jerome M. Hesch, *Intrafamily Sales and OID Safe Harbors: Transfer Tax Anomalies*, 17 Tax Mgmt. Est., Gifts & Tr. J. 131 (1992); Andrew R. Henderson, *Using the Imputed Interest Safe Harbor for Intrafamily Installment Sales*, 74 J. Tax'n 100 (1991). We find these sources unpersuasive to the extent they conflict with the plain language of I.R.C. §§ 483, 2512.

present discounted value of the promissory notes. The IRS was entitled to tax this amount as a gift under § 2501(a)(1).

In sum, we hold that although the promissory notes bore interest at the § 483 safe harbor rate, the IRS was entitled under § 2512 to determine the discounted present value of the notes using the prevailing market interest rate. Accordingly, we AFFIRM the district court's order granting summary judgment in favor of Defendant United States.

IN THE

United States District Court

FOR THE NORTHERN DISTRICT OF OKLAHOMA

CHARLES SCHUSTERMAN and
LYNN N. SCHUSTERMAN,
Plaintiffs,
vs.
UNITED STATES OF AMERICA,
Defendant.

No. 92-C-590-E

ORDER AND JUDGMENT

The Court has for consideration the cross-motions of the parties for summary judgment (docket numbers 7 and 11, respectively). This is a tax refund case. The parties have stipulated to the following facts:

1. Plaintiffs are Charles Schusterman and Lynn N. Schusterman (collectively the "Plaintiffs") , who are husband and wife and are both residents of Tulsa, Oklahoma, and citizens of the United States of America.

2. Defendant is the United States of America.

3. Jurisdiction is conferred upon this Court by 28 U.S.C. Section 1346(a)(1).

4. As Plaintiffs are residents of Oklahoma, venue for this action is in the Northern District of Oklahoma pursuant to 28 U.S.C. Section 1396.

FIRST TRANSACTION

5. On September 21, 1980 Plaintiff Charles Schusterman transferred 420 shares of Tilco, Inc. ("Tilco") Class "B" common stock to five irrevocable trusts, the beneficiaries of which are his descendants (the "Trusts"). The trustees of the Trusts exe-

cuted and delivered promissory notes made to Plaintiff Charles Schusterman (the "Notes") in exchange for the Tilco stock. The total principal amount of the Notes was $7,954,046.60, and the terms of the Notes provided for interest at six percent (6%) per annum. The Notes were executed on September 21, 1980. The face amount, maturity date and maker of each Note is set forth below:

Maker	Date of Maturity	Face Amount
Stacy Helen Schusterman Irrevocable Trust (three notes, secured by 153 shares of Tilco stock)	10-1-80	$ 144,877.28
	1-4-82	144,877.28
	9-21-00	2,607,791.04
Total of three notes		2,897,545.60
Jerome Reed Schusterman Irrevocable Trust (three notes, secured by 153 shares of Tilco stock)	10-1-80	$ 144,877.28
	1-4-82	144,877.28
	9-21-00	2,607,791.04
Total of three notes		2,897,545.60
Stacy Helen Schusterman's Children's Irrevocable Trust (three notes, secured by 38 shares of Tilco stock)	10-1-80	$ 35,982.59
	1-4-82	35,982.59
	9-21-00	647,686.62
Total of three notes		719,651.80
Jerome Reed Schusterman's Children's Irrevocable Trust (three notes, secured by 38 shares of Tilco stock)	10-1-80	$ 35,982.59
	1-4-82	35,982.59
	9-21-00	647,686.62
Total of three notes		719,651.80
Harold Josey Schusterman's Children's Irrevocable Trust (three notes, secured by 38 shares of Tilco stock)	10-1-80	$ 35,982.59
	1-4-82	35,982.59
	9-21-00	647,686.62
Total of three notes		719,651.80
Total Face Amount of the Notes		$7,954,046.60

6. Relying on the recommendation of professional advisors, whose opinion was based on their interpretation of the language of Internal Revenue Code Section 483(a) and Treasury Regulations Sections 1.483-1(a)(1) and 1.483-1(d)(1)(ii)(B), Plaintiff Charles Schusterman and the trustees of the Trusts set the interest rate on the Notes at the rate of six percent (6%) per annum.

7. In examining this transfer of stock between Plaintiff Charles Schusterman and the Trusts, the Internal Revenue Service (the "IRS") determined that a gift had been made to the Trusts. The IRS disregarded the interest rate on the Notes, and instead applied an annual discount rate of eleven and one-half percent (11.5%), citing Internal Revenue News Release IR-84-60, dated May 11, 1984 (subsequently reprinted in Revenue Procedure 85-46, 1985-2 C.B. 507). The IRS characterized as a gift the difference between the fair market value of the Tilco stock transferred to the Trusts and the present value of the Notes as calculated using the 11.5% discount rate.

8. Plaintiffs each properly consented to having the alleged gift considered as having been made one-half by Plaintiff Lynn N. Schusterman and one-half by Plaintiff Charles Schusterman.

9. Plaintiffs each timely filed gift tax returns and each timely paid to the IRS the gift tax as assessed by the IRS for the quarter ending September 30, 1980, in the amount of $528,043.61, plus interest thereon in the amount of $578,563.86, and each timely filed a proper claim for refund of the tax and interest paid by them, plus interest thereon as allowed by law.

10. In their claims for refund, each of Plaintiffs claimed as follows:

> "Taxpayer [Plaintiff Charles Schusterman) made installment sales to trusts he established for the benefit of his children and grandchildren in 1980. These sales were subject to the provisions of Internal Revenue Code Section (IRC)

483. Under the provisions of that section, if the loan bears an interest rate at the minimum test rate of Treasury Regulation Section 1.4831(d)(1)(ii), then no portion of the loan can be recharacterized as something other than principal. The test rate which applies to the loan at issue is 6% which is the interest rate which the loans bear.

The examining agent concluded that the interest rate should have been 11.5% and the difference between the present values of the loan at 6% and 11.5% would be a gift subject to gift tax. The agent maintained that IRC 483 did not apply to the gift tax provisions of the Internal Revenue Code.

The taxpayer maintains that the statement in the statute itself (IRC 483(a)), Treasury Regulation Section 1.483-1(a)(1), and in the Committee Reports (see page 332 of 1964-1 C.B. (Part 2)) that IRC 483 is to apply for all purposes of the Internal Revenue Code means just that. Therefore, no gift was made and the taxpayer claims a refund of the tax paid."

11. Following the disallowance of their claims by the IRS, Plaintiffs timely filed the instant refund action in the United States District Court for the Northern District of Oklahoma.

12. If the Court determines that the 6% rate used by Plaintiffs is inapplicable to the stock-transfer transaction, then the 11.5% rate used by the IRS is applicable.

* * *

[The trial in the District Court also involved a second transaction that was not considered on appeal and which is not relevant to this Petition for Certiorari]

As to the *First Transaction*, the issue presented to this Court may be stated as follows:

1. Were the Plaintiffs entitled to rely on § 483 of the Internal Revenue Code in computing interest on the Notes which were taken in exchange for the Tilco Stock at 6% per annum and thereby claim a safe-harbor from the imputation of gift tax to the transaction?

Section 483 of the Code states in pertinent part as follows:

> For purposes of this title, in the case of any payment under any contract for the sale or exchange of any property, and to which this section applies, there shall be treated as interest that portion of the total unstated interest under such contract which . . . is properly allocable to such payment.

Plaintiffs urge this Court to adopt a broad application of § 438. In support of their position the Plaintiffs cite to the express language of the Section, its legislative history and its corresponding regulation: Treas.Reg/§ 1.483-1(a)(1) and to the cases of *Ballard v. Comm'r*, 854 F.2d 185 (7th Cir. 1988), rev'g TCM 1987-128 (1987) ; *Fox v. USA*, 62 AFTR2d 88-5947 (D.C. Va. 1988); *Kingsley v. Comm'r*, 662 F.2d 539 (9th Cir. 1981), affg 72 TC 1095 (1979) (one of the "reorganization cases" in which § 483 is deemed to be applicable to the reorganization provisions of the Code because it was enacted for the purpose of preventing parties from converting any part of a payment from interest income into capital gain). Plaintiffs further assert that taking the position asserted by the USA would create a conflict in the calculations of the income tax basis of the transferred property in the hands of the transferee and the amount of gain to be recognized by the transferor. Finally, they cite *Crown v. Comm'r*, 585 F.2d 234, 240 (7th Cir. 1978) for the general proposition that equity does not favor the imputation of a gift.

In considering Plaintiffs' position the Court has compared the reasoning of the *Ballard* case and its construction of § 483 with that of the *Krabberhoft* [sic] case which Defendant cites in support of its position that § 483 cannot be employed as a "safe

harbor" from the application of market interest rates for purposes of gift tax valuation. *Krabberhoft* [sic] *v. Commissioner*, 939 F.2d 529 (8th Cir. 1991). In making its evaluation of the relative merits of the approach taken by each case, this Court must bear in mind that it is Plaintiffs' burden to rebut the presumption of the validity of a federal tax assessment. *Dolese v. Commissioner*, 811 F.2d 543 (10th Cir. 1987).

In *Ballard* Plaintiff executed a contract for conditional sale of real estate in favor of her children for the purchase of her farm. Under the installment terms of the contract the children agreed to pay six percent interest on the principal. Plaintiff then reported a gift to the extent of the difference between the fair market value of the property and the face value of the contract. *Id.* at 186. The Service contested the six per cent interest rate claiming that Section 483 did not apply to the transaction. The U.S. Tax Court agreed:

> The issue in this case is valuation, namely, the value for gift tax purposes of the consideration received by petitioner in transferring the real estate described in the contract for sale ... Section 483 has nothing to do with valuation ...

Id. at 187, quoting the Tax Court (citation omitted). On appeal, the Seventh Circuit reversed, finding the Plaintiff's construction of the plain meaning of the statute compelling. The Plaintiff argued, and the Circuit agreed, that the Section's prefatory language: "For purposes of this title" meant exactly what it said. That is, Congress intended the Section to apply to all sections of the Code, including the gift tax provisions. Finding the plain meaning of the statute clear and unambiguous the Circuit did not consider the legislative history of the section. *Id.* at 188. It seems to this Court that the Circuit's decision begs the question. While § 483 indisputably applies to the entire Code, the question at bar is — how should it apply. Put another way, were Plaintiffs entitled to rely on § 483 for valuation purposes under the factual scenario herein?

Finding the analysis of § 483 presented by the Eighth Circuit in *Krabberhoft* [sic] *v. Commissioner*, 939 F.2d 529 (8th Cir. 1991) both applicable and persuasive, the Court concludes that Plaintiffs were not so entitled. In *Krabbenhoft*, Plaintiffs transferred realty to their children by way of a contract for deed which provided for thirty annual installment payments and a per annum interest rate of 6 per cent. The transaction is clearly analogous to the pivotal facts in the instant case. Further, the Krabbenhofts claimed safe harbor protection by designating a § 483 six per cent interest rate. The Tax Court affirmed the Service's determination that § 483 was inapplicable to the valuation of the transaction for purposes of computing gift tax liability and that the Plaintiffs failed to prove that the eleven per cent interest rate employed by the Service was improper. The Eighth Circuit concurred. It found that while § 483 applies to the entire Code, as asserted by Plaintiffs, the Section does not speak to valuation.

> The section merely characterizes payments as principal or interest, while gift tax valuation is concerned with the value of all payments, whether principal or interest. The character of a payment does not affect its value for gift tax purposes.

Id. at 532.

Thus, § 483 is irrelevant to a 26 U.S.C. § 2512 valuation of gifts. As an ancillary issue, then, the Court must reject Plaintiffs' argument that the government's position will result in a conflict over which sales price to compute: the one pursuant to § 2512 or the one "mandated by § 483". It is the opinion of this Court that § 483 is inapplicable to "sales price" or valuation determination, hence no conflict arises.

In *Krabberhoft* [sic], the Circuit found that the Service's designation of an eleven per cent interest rate for purposes of ascertaining the present value of the contract was not erroneous. The evidence adduced at trial of rates for similar transactions substantiated the Service's computation of fair market value.

Thus, Plaintiffs failed to meet their burden of showing the method was incorrect. *Id.* at 544-534. In the instant case, the Service properly rejected the use of § 483 for valuation purposes of the transaction and Plaintiff has failed to rebut the presumption that the evidence produced by the Service in support of its use of an eleven and one-half per cent discount rate was proper. *See*, United States Memorandum in Support of Motion for Summary Judgment p. 2, n. 2. Pursuant to Stipulation #12 of the parties, *supra*, the Court finds that the eleven and one-half percent rate is proper.

* * *

Accordingly, the Service's determinations as to both issues will be upheld; Plaintiffs' Motion for Summary Judgment will be DENIED; Defendant's Motion for Summary Judgment will be GRANTED. Judgment will be entered in favor of Defendant and against the Plaintiffs. Plaintiffs will take nothing from this action. Case DISMISSED.

ORDERED this 18th day of February, 1994.

JAMES O. ELLISON

JAMES O. ELLISON, Chief Judge
UNITED STATES
DISTRICT COURT

United States Court of Appeals
FOR THE TENTH CIRCUIT

CHARLES SCHUSTERMAN AND
LYNN N. SCHUSTERMAN,
Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

No. 94-5106

ORDER
Entered October 20, 1995

Before ANDERSON, BARRETT and BALDOCK, Circuit Judges.

This matter comes on for consideration of appellants' petition for rehearing and suggestion for rehearing *in banc.*

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision.

In accordance with Rule 35(b), Federal Rules of Appellate Procedure, the suggestion for rehearing *in banc* was transmitted to all of the judges of the court who are in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing *in banc,* Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing *in banc* is denied.

Entered for the Court
ROBERT L. HOECKER, Clerk

By: OPAL A. CARTER
Opal Carter, Deputy Clerk

SEC. 483. INTEREST ON CERTAIN DEFERRED PAYMENTS.

(a) Amounts Constituting Interest. — For purposes of this title, in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which this section applies which are due under such contract.

(b) Total Unstated Interest. — For purposes of this section, the term "total unstated interest" means, with respect to a contract for the sale or exchange of property, and amount equal to the excess of —

(1) the sum of the payments to which this section applies which are due under the contract, over

(2) the sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of paragraph (2), the present value of the payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary. Such regulations shall provide for discounting on the basis of 6-month brackets and shall provide that the present value of any interest payment due not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment.

(c) Payments to Which Section Applies. —

(1) In general. — Except as provided in subsection (f), this section shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract —

(A) under which some or all of the payments are due more than one year after the date of such sale or exchange, and

(B) under which, using a rate provided by regulations prescribed by the Secretary for purposes of this subparagraph, there is total unstated interest.

Any rate prescribed for determining whether there is total unstated interest for purposes of subparagraph (B) shall be at least one percentage point lower than the rate prescribed for purposes of subsection (b)(2).

(2) Treatment of evidence of indebtedness. — For purposes of this section, an evidence of indebtedness of the purchaser given in consideration for the sale or exchange of property shall not be considered a payment, and any payment due under such evidence of indebtedness shall be treated as due under the contract for the sale or exchange.

(d) Payments that are indefinite as to time, liability, or amount. — In the case of a contract for the sale or exchange of property under which the liability for, or the amount or due date of, any portion of a payment cannot be determined at the time of the sale or exchange, this section shall be separately applied to such portion as if it (and any amount of interest attributable to such portion) were the only payments due under the contract, and such determinations of liability, amount, and due date shall be made at the time payment of such portion is made.

(e) Change in Terms of Contract. — If the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property is changed, the "total unstated interest" under the contract shall be recomputed and allocated (with adjustment for prior interest (including unstated interest payments) under regulations prescribed by the Secretary.

(f) Exceptions and Limitations. —

(1) Sales price of $3,000 or less. — This section shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed $3,000.

(2) Carrying charges. — In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be made without regard to this section if any such amounts are treated under section 163(b) as if they included interest.

(3) Treatment of seller. — In the case of the seller, the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to this section if all of the gain, if any, on such sale or exchange would be considered as ordinary income.

(4) Sales or exchanges of patents. — This section shall not apply to any payments made pursuant to a transfer described in section 1235(a) (relating to sale or exchange of patents).

(5) Annuities. — This section shall not apply to any amount the liability for which depends in whole or in part on the life expectancy of one or more individuals and which constitutes an amount received as an annuity to which section 72 applies.

VALUATION OF GIFTS

Sec. 2512 [1986 Code]. (a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

(b) Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

(c) Cross References.

§ 1.483-1 Computation of interest on certain deferred payments

(a) Computation of amount constituting interest — (1) General rule. For all purposes of the Internal Revenue Code, in the case of any contract for the sale or exchange of property, there shall be treated as interest that part of a payment to which section 483 applies (see paragraph (b) of this section) which bears the same ratio to the amount of such payment as the total unstated interest (as defined in paragraph (c) of this section) under such contract bears to the total of the payments to which section 483 applies which are due under such contract. Thus, the amount to be treated as interest under section 483 is determined by multiplying each payment to which such section applies by a fraction, the numerator of which is the total unstated interest under the contract, and the denominator of which is the total of all the payments to which section 483 applies which are due under such contract. The effect of this ratio is to allocate the total unstated interest on a pro rata basis among the total payments to which section 483 applies. Accordingly, the total amount to be treated as interest for a taxable year with respect to a contract under which there are payments which include unstated interest is an amount equal to the unstated interest allocated to the payments under the contract for such year plus any stated interest reportable under the contract for such year. See paragraph (b) (2) of this section for rules relating to allocation of contract price, payments, and stated interest; paragraph (e) of this section for rules relating to indefinite payments; paragraph (f) of this section for rules relating to changes in terms of contract; and paragraph (b) of § 1.483-2 for exceptions and limitations to the application of section 483.

* * *

(b) Payments to which section 483 applies — (1) In general. Except as provided in subparagraph (4) of this paragraph, sec-

tion 483 applies to any payment made after December 31, 1963, on account of the sale or exchange of property occurring after June 30, 1963, which payment constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract —

(i) Under which one or more of the payments are due more than 1 year after the date of such sale or exchange, and

(ii) Under which there is "total unstated interest" (within the meaning of paragraph (d) of this section).

For purposes of the preceding sentence, the term "sales price" does not include any interest payments provided for in the contract. The term "sale or exchange" includes any transaction treated as a sale or exchange for purposes of the Code. For purposes of section 483, a payment may be made in cash, stock or securities, or other property (except as provided in subparagraph (5) of this paragraph). Section 483 does not apply to any deferred payments under a contract under which all of the payments are due no more than 1 year after the date of the sale or exchange. Section 483 does not apply to a distribution in complete liquidation of a corporation, regardless of whether the corporation is liquidated in one distribution or in a series of distributions. For special rules relating to the time a sale or exchange takes place in the case of a disposal of timber, coal, or domestic iron ore, which qualifies under section 631 (relating to gain or loss in the case of timber, coal, or domestic iron ore), see that section and the regulations thereunder. See paragraph (e) of this section for special rules relating to indefinite payments, and paragraph (f) of this section for rules relating to the effect of a late payment on the determination of the due date of such payment. Section 483 may apply whether the contract providing for deferred payments is expressed (whether written or oral) or implied. In general, for purposes of section 483, all sales or exchanges involving deferred payments are considered as made under a contract.

(2) Allocation of contract price, payments, and stated interest. If payments are due under a contract both for the sale or exchange of property to which section 483 applies (for example, capital assets) and for either the sale or exchange of property to which such section does not apply (for example, the transfer of patents described in section 1235(a)) or services rendered or to be rendered, the parties to the contract may agree at the time of the sale or exchange on a reasonable determination of the portion of the contract price and the stated interest (if any), and of each payment due under the contract, which is allocable to each such type of property and to services. However, if the parties do not so agree on a reasonable determination of the allocation of the contract price, or the stated interest (if any), or each payment due under the contract, the district director shall make such reasonable determination.

(3) Effect of other provisions of law. If there is total unstated interest under a contract, a portion of each payment to which section 483 applies shall be treated as interest to the extent provided in such section, notwithstanding that some other provision of law (for example, section 1245, relating to gain from dispositions of certain depreciable property) would, without regard to section 483, treat a portion of the payment as ordinary income or in some other manner. In such a case, section 483 shall apply first and the other provision of law shall apply only to the remainder of the payment not treated as interest under section 483. For example, if a portion of a payment is treated as interest under section 483 and such portion would otherwise be treated as gain from the sale or exchange of property which is not a capital asset under section 1232(a)(2)(B) (relating to corporate bonds issued on or before May 27, 1969, and Government bonds), section 483 shall apply first and section 1232(a)(2)(B) shall apply only to the remainder of the payment after the interest portion has been determined. In such case, in order to avoid a double inclusion in income, for purposes of section 1232(b) the

"stated redemption price at maturity" shall be reduced by any amount treated as interest under section 483. If, however, with respect to an evidence of indebtedness issued by a corporation after May 27, 1969, any amount of original issue discount is ratably includible in the gross income of the holder under section 1232(a)(3) there will be no unstated interest to which section 483 applies since paragraph (d) (3) of this section provides for a zero test rate of interest for determining whether there is total unstated interest with respect to such an evidence of indebtedness.

* * *

(c) Total unstated interest — (1) In general. For purposes of paragraph (a) of this section (that is, for purposes of determining the portion of a payment to which section 483 applies which is to be treated as interest), the term "total unstated interest" means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of —

(i) The sum of the payments to which section 483 applies which are due under the contract (within the meaning of paragraph (b) of this section), over

(ii) The sum of the present values of such payments and the present values of any stated interest payments due under the contract.

(2) Present value of a payment (i) In general. The present value of any interest payment due under the contract not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment. The present value of any other interest payment, and of any payment to which section 483 applies, which is due under the contract shall be determined by discounting such payment at the interest rate prescribed by paragraph (c)(2)(ii) of the section, from the nearest date (to the date such payment is actually due under the contract) which marks a 6-month interval from the date of the sale or exchange.

For purposes of computing the present value of a payment at such rate, column (b) of the appropriate table set forth in paragraph (g)(2) of this section shall be used.

(ii) Prescribed interest rates. (A) For payments on account of a sale or exchange of property entered into before July 24, 1975, as well as a sale or exchange of property pursuant to a binding written contract (including an irrevocable written option) entered into before such date, the interest rate prescribed by this subdivision shall be 5 percent per annum compounded semi-annually.

(B) For payments on account of a sale or exchange of property entered into on or after July 24, 1975, except a sale or exchange entered into pursuant to a binding written contract (including an irrevocable written option) entered into before such date, the interest rate prescribed by this subdivision shall by 7 percent per annum compounded semiannually. (See paragraph (c)(4) of this section for special rules where there has been a substantial change in the terms of a binding written contract entered into before July 24, 1975.)

* * *

(d) Test of whether there is total unstated interest under a contract — (1) In general — (i) How to apply prescribed test rate. Except as provided in paragraph (d)(2) and (3) of this section for purposes of determining whether section 483 applies to payments under a contract (that is, for purposes of paragraph (b)(1)(ii) of this section), the determination of whether there is total unstated interest under a contract shall be made in accordance with the method for computing total unstated interest provided in paragraph (c) of this section, except that column (a) of the appropriate table contained in paragraph (g)(2) of this section (which provides for discounting payments at the appropriate test rate prescribed by paragraph (d)(1)(ii) of this section) shall be used to determine the present value of a payment. If, after applying the appropriate test rate, there is total unstated

interest (regardless of amount) with respect to a contract, section 483 applies to the payments described in paragraph (b) of this section which are due under the contract. In such case, the amount of total unstated interest under the contract which is includible in or deductible from income must be computed by using the higher interest rate prescribed in paragraph (c) of this section, and then allocating such amount among the payments due under the contract in the manner provided in paragraph (a) of this section.

(ii) Prescribed test rates. (A) For payments on account of a sale or exchange of property entered into before July 24, 1975, as well as a sale or exchange of property entered into pursuant to a binding written contract (including an irrevocable written option) entered into before such date, the test rate prescribed by this subdivision shall be 4 percent per annum simple interest.

(B) For payments on account of a sale or exchange of property entered into on or after July 24, 1975, except a sale or exchange entered into pursuant to a binding written contract (including an irrevocable written option) entered into before such date, the test rate prescribed by this subdivision shall be 6 percent per annum simple interest. (See paragraph (c)(4) of this section for special rules where there has been a substantial change in the terms of a contract entered into before July 24, 1975.)

(2) Alternative test where contract rate is at least that prescribed in paragraph (d)(1)(ii) of this section. The method provided in paragraph (d)(1) of this section for determining whether there is total unstated interest need not be used in the case of a contract which provides for interest at a rate of at least that prescribed in paragraph (d)(1)(ii) of this section, payable on each installment of principal at the time such installment is payable. For purposes of paragraph (b)(1)(ii) of this section, there is no total unstated interest under such a contract and, therefore, section 483 does not apply to payments under such a contract. For purposes of this paragraph, simple interest means

straight interest computed on the principal amount of a payment from the time of the sale or exchange to the time the payment is required to be made. As an illustration of the meaning of simple interest, if a contract provides for payments totaling $6,000 in 3 equal installments of $2,000 plus 4 percent per annum simple interest, such installments of principal and interest being due 1, 2, and 3 years, respectively, from the date of the sale, the amount of interest due with the first installment is $80 ($2,000 \times 0.04 \times 1$), the amount of interest due with the second installment is $160 ($2,000 \times 0.04 \times 2$), and the amount of interest due with the third installment is $240 ($2,000 \times 0.04 \times 3$).

* * *

Supreme Court, U.S.
FILED
APR 19 1996
CLERK

(2)

No. 95-1155

In the Supreme Court of the United States

OCTOBER TERM, 1995

CHARLES SCHUSTERMAN AND
LYNN N. SCHUSTERMAN, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

DREW S. DAYS, III
Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
RICHARD FARBER
CHARLES BRICKEN
Attorneys
Department of Justice
Washington, DC 20530
(202) 514-2217

25pp

QUESTION PRESENTED

Whether Section 483 of the Internal Revenue Code, 26 U.S.C. 483, relieves petitioners of gift tax liability that otherwise would be imposed under Section 2512(b), 26 U.S.C. 2512(b), on their below-market installment sale of property to their children.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutes and regulations involved	2
Statement	2
Argument	8
Conclusion	14
Appendix	1a

TABLE OF AUTHORITIES

Cases:

Ballard v. *Commissioner*, 854 F.2d 185 (7th Cir. 1988)	7, 8, 10
Blackburn v. *Commissioner*, 20 T.C. 204 (1953)	9
Commissioner v. *Wemyss*, 324 U.S. 303 (1945)	4
Estate of Berkman v. *Commissioner*, 38 T.C.M. (CCH) 183 (1979)	9
Estate of Reynolds v. *Commissioner*, 55 T.C. 172 (1970)	
Frazee v. *Commissioner*, 98 T.C. 554 (1992)	8, 11
Krabbenhoft v. *Commissioner*, 939 F.2d 529 (8th Cir. 1991), cert. denied, 502 U.S. 1072 (1992)	6, 8
Mason v. *United States*, 513 F.2d 25 (7th Cir. 1975)	9

Statutes and regulations:

Internal Revenue Code (26 U.S.C.):

§ 453	12
§ 483 (1976)	2, 3, 5, 6, 7, 8, 9, 10, 11-12, 13
§ 483(a)(1976)	10, 14
§ 483(a)-(c) (1976)	14
§ 483(e)(formerly § 483(g))	14
§ 1001	12, 13
§ 1001(b)	12
§ 1274(b)(2)(B)	13
§ 1274(c)(3)(F)	14

Statutes and regulations—Continued: Page

§ 1274(d) 2, 5, 9, 11, 13
§ 1274(d)(1)(B) 13
§ 1274(d)(2)(B) 4
§ 2501 ..... 2, 3, 7
§ 2512 ..... 2, 7, 9, 10
§ 2512(a) 4
§ 2512(b) 4, 9, 13
§ 7872 2
§ 7872(e)(i) 13
Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494:
§ 41(a), 98 Stat. 31 ..... 4, 8, 13
§ 172(a), 98 Stat. 699 4
26 C.F.R.:
Section 1.483-1 (1980) 2
Sections 1.483-1 to 1.483-3 ..... 2, 11
Section 1.483-1(a) 4, 13
Section 1.483-1(c)(2)(ii)(B) (1980) 3
Section 1.483-1(d)(1)(ii)(B) (1980) 3, 5
Section 1.483-2 4
Section 1.483-2(a)(1)(i) 13
Section 1.483-2(a)(2) 13
Section 1.483-3(a) 4, 13
Section 1.483-3(b)(1) 14
Section 25.2512-8 ..... 2, 4

Miscellaneous:

H.R. Rep. No. 749, 88th Cong., 1st Sess. (1963) 3
IRS Gen. Couns. Mem., G.C.M. 39,566 (Oct. 23, 1986) 11
S. Rep. No. 830, 88th Cong., 2d Sess. (1964) 3

In the Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-1155

CHARLES SCHUSTERMAN AND
LYNN N. SCHUSTERMAN, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A16) is reported at 63 F.3d 986. The order and judgment of the district court (Pet. App. A17-A24) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on August 22, 1995. A petition for rehearing was denied on October 20, 1995 (Pet. App. A25). The petition for a writ of certiorari was filed on January 17, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The relevant portions of Sections 483 (1976) and 2512 of the Internal Revenue Code (26 U.S.C.) and of former Treasury Regulation § 1.483-1 (26 C.F.R.) (1980) are set forth at Pet. App. A26-A36. The relevant portions of Sections 1274(d), 2501 and 7872 of the Internal Revenue Code (26 U.S.C.), Treasury Regulation § 25.2512-8, and current Treasury Regulations §§ 1.483-1 to 1.483-3 (26 C.F.R.) are set forth in the Appendix, *infra*, 1a-4a.

STATEMENT

1. a. In 1980, when the transactions at issue in this case took place, capital gains were taxed at a lower rate than ordinary income, while the interest portion of deferred payments received for the sale of capital was fully taxable as ordinary income. Section 483 of the Internal Revenue Code governs unstated interest in installment sales of property where part or all of the payments are due more than one year after the date of the sale. If no interest rate is stated in such an installment contract, or if the stated interest rate is less than a specified minimum rate (the "test" or "safe harbor" rate), the Internal Revenue Service (IRS) will impute interest to the transaction. 26 U.S.C. 483 (Pet. App. A26-A27). Thus, where a contract contains unstated interest, Section 483 allows the IRS to recharacterize a portion of the deferred payments due under the contract as interest rather than as capital gain, and to tax the interest portion as ordinary income.

The Department of the Treasury's regulations implementing Section 483 set forth the minimum interest rates necessary to avoid the imputation of interest. As effective during September, 1980, the regula-

tions provided that no interest would be imputed in a transaction that provided for the payment of interest at a rate of six percent or greater. 26 C.F.R. 1.483-1(d)(1)(ii)(B) (1980) (Pet. App. A35). If the transaction provided for payment of interest at less than six percent, the IRS would impute a seven percent interest rate. 26 C.F.R. 1.483-1(c)(2)(ii)(B) (1980) (Pet. App. A34).

Congress enacted Section 483 in 1964 to curb a specific abuse under the income tax laws. Before Section 483 was enacted, if the parties to a contract for the sale of a capital asset on an installment basis did not expressly provide for the payment of interest on the deferred payments, the seller, reporting her or his gain under the installment method, could treat the entire amount received (to the extent it exceeded the seller's adjusted basis in the property) as capital gain, even though some of that amount in reality represented interest income on the deferred payments of principal. In this manner, interest income was hidden as capital gain, and taxed at lower rates. Congress enacted Section 483 to prevent that specific manipulation of the income tax laws. S. Rep. No. 830, 88th Cong., 2d Sess. 102 (1964); H.R. Rep. No. 749, 88th Cong., 1st Sess. 72 (1963). (To the extent, however, that market interest rates exceeded the six percent test rate specified in the regulation, the seller who reported only a six percent interest rate still enjoyed a limited tax saving on the interest on the deferred payments.)

b. Installment contracts may also effectuate gifts, on which gift tax may be due. The Code imposes a tax on any "transfer of property by gift" made by an individual during the calendar quarter. 26 U.S.C. 2501 (App., *infra*, 1a). The value of a gift is determined as

of the date of the gift. 26 U.S.C. 2512(a) (Pet. App. A29). When property is transferred for less than full consideration, "the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift," and is thus subject to gift tax. 26 U.S.C. 2512(b) (Pet. App. A29). The applicable regulations specify that transfers reached by the gift tax include "sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor." 26 C.F.R. 25.2512-8 (App., *infra*, 4a). See, generally, *Commissioner* v. *Wemyss*, 324 U.S. 303, 306 (1945). When a gift includes interest foregone (*i.e.* when it is effectuated through a below-market loan or a sale with deferred payments at below-market interest rates), the value of the gift is determined by reference to market interest rates.

c. As part of broad tax reform legislation in 1984, Congress added Section 1274(d) to the Internal Revenue Code. Tax Reform Act of 1984, Pub. L. No. 98-369, §§ 41(a), 172(a), 98 Stat. 531, 540, 699. Section 1274(d) adopted an adjustable, market-based interest rate—referred to as the Applicable Federal Rate, or AFR—for use as, *inter alia*, the test rate under Section 483 for determining when installment sales contain unstated interest, see 26 C.F.R. 1.483-1(a), 1.483-2, 1.483-3(a) (effective April 4, 1994) (App., *infra*, 2a-3a), and for use in valuation of debt instruments issued in exchange for property, 26 U.S.C. 1274(b)(2)(B).[1]

---

[1] There are three Applicable Federal Rates: a short-term rate for obligations maturing in three years or less from the

2. On September 21, 1980, petitioners transferred 420 shares of Tilco, Inc., Class B common stock to five irrevocable trusts of which the beneficiaries were their descendants. Pet. App. A2, A17. The fair market value of the stock at the time of the transfers was $7,956,046.60. *Ibid.* The trustees of the trusts issued promissory notes to petitioners with a stated aggregate principal amount of $7,956,046.60. *Ibid.* The notes were payable over terms of up to 20 years, at a stated annual interest rate of six percent. *Id.* at A2, A18. Petitioners and the trustees chose to have the notes bear interest at the rate of six percent because that was the "safe harbor" or "test" rate under Section 483 when the notes were issued. *Id.* at A2.

The IRS examined the transfers of stock between petitioners and the trusts and determined that petitioners had made taxable gifts to the trusts on which they owed gift taxes. Pet. App. A2. In making that determination, the IRS did not challenge the parties' valuation of the Tilco stock at $7,954,046.60, but observed that the current fair market value of the promissory notes paid in exchange for the stock was substantially less than the stock. The IRS informed petitioners that their use of the test rate under Section 483 and Treasury Regulation § 1.483-1(d)(1)(ii)(B) (1980) did not preclude valuation of the payments due under the promissory notes in accordance with the

---

issue date, a mid-term rate applied to obligations with terms of more than three but not more than nine years and a long-term rate for obligations maturing more than nine years from issue. The AFRs are determined and published by the IRS monthly and are based on the "average market yield" on outstanding marketable obligations of the United States with maturity dates falling within the three ranges. See 26 U.S.C. 1274(d) (App., *infra*, 1a-2a).

prevailing market interest rate, which the parties stipulated to be 11.5 percent. Pet. App. A2-A3. Discounting the value of the payments due under the promissory notes by 11.5 percent over their 20-year terms revealed their present value to be $4,601,551. *Id.* at A3. The IRS determined that the $3,352,489 by which the value of the stock exceeded the present fair market value of the notes petitioners received in exchange constituted taxable gifts by petitioners to the trusts. *Id.* at A3.

Petitioners each filed gift tax returns and each paid gift taxes of $528,043.61 for the quarter ended September 30, 1980, and assessed interest of $578,563.86. Pet. 5; Pet. App. A19. They filed timely claims for refund of the gift taxes and assessed interest paid, together with statutory interest. Pet. App. A3. The IRS disallowed the refund claims, and petitioners sued in district court. *Ibid.*

3. On cross-motions for summary judgment, the district court granted judgment in favor of the government. Pet. App. A17-A24. The court rejected petitioner's "broad application of § 483," and instead followed *Krabbenhoft* v. *Commissioner*, 939 F.2d 529, 532 (8th Cir. 1991), cert. denied, 502 U.S. 1072 (1992), which held that Section 483 is concerned only with the characterization of a payment as principal or interest—an issue that does not affect its actual fair market value for gift tax purposes. The district court concluded that, although Section 483 applies "[f]or purposes of this title," *i.e.*, for purposes of the entire Internal Revenue Code, characterization of amounts

paid as interest or principal "is irrelevant to a 26 U.S.C. § 2512 valuation of gifts." Pet. App. A23.[2]

4. The court of appeals affirmed. Pet. App. A1-A16. The language of the statute did not, in the court's view, support petitioner's position: "We believe a careful examination of the plain language of the statute reveals Congress' clear intent in enacting § 483. Section 483 insures that a taxpayer does not avoid income taxes by structuring an installment contract to provide only for the payment of principal (taxed as capital gains) without interest (taxed as ordinary income)." *Id.* at A8. Section 483 thus determines only "whether payments under an installment sales contract contain interest hidden as principal." *Id.* at A13.

The court noted that Sections 2501 and 2512, in contrast, deal not with imputation of interest, but with valuation and taxation of gifts. Those Sections authorize the IRS to "impose a gift tax when the value of property transferred by a taxpayer exceeds the present value of a promissory note that bears a below market interest rate." Pet. App. A9. The court stated that "the safe harbor interest rate referenced in I.R.C. § 483(c)(1)(B) and specified in Treas. Reg. § 1.483-1(d)(1)(ii)(B) is irrelevant to gift tax valuation under I.R.C. § 2512." Pet. App. A13. "[A]lthough the safe harbor rate insulates a taxpayer from the adverse income tax effects of § 483(a), we find nothing in § 483 that indicates that the safe harbor rate insu-

---

[2] The district court declined to follow *Ballard* v. *Commissioner*, 854 F.2d 185 (7th Cir. 1988), which relied principally on the phrase "[f]or purposes of this title." Acknowledging that "§ 483 indisputably applies to the entire Code," the district court believed that reasoning "begs the question" of "how should it apply." Pet. App. A22.

lates a taxpayer from the adverse gift tax effects of § 2512." *Id.* at A14.

The court accordingly concluded that, under Section 483, the promissory notes petitioners received "do not contain interest hidden as principal." Pet. App. A15. "Because the notes bore interest below the market rate," however, petitioners "made a gift to the trusts consisting of the difference between the value of the stock and the present discounted value of the promissory notes." *Id.* at A15-A16. The court held that, "although the promissory notes bore interest at the § 483 safe harbor rate, the IRS was entitled under § 2512 to determine the discounted present value of the notes using the prevailing market interest rate." *Id.* at A16.

ARGUMENT

Certiorari should be denied because the decision of the court of appeals is correct, and what minimal practical impact the question may have had has been eliminated by the Tax Reform Act of 1984, Pub. L. No. 98-369, § 41(a), 98 Stat. 531, 540, and current Treasury Regulations implementing the 1984 Act. In the 32 years that have elapsed since Section 483 was enacted, the question presented here has arisen in only three other reported cases. This Court denied certiorari in *Krabbenhoft* v. *Commissioner*, 939 F.2d 529, 532 (8th Cir. 1991), cert. denied, 502 U.S. 1072 (1992), notwithstanding that that decision, like the court of appeals' decision in this case, conflicted with *Ballard* v. *Commissioner*, 854 F.2d 185 (7th Cir. 1988).[3] Those cases, like this one, dealt with pre-1984

[3] See also *Frazee* v. *Commissioner*, 98 T.C. 994 (1992) (following *Krabbenhoft*).

transactions. The 1984 Act has since removed any lingering doubt about the correct application of these statutes by adding Section 1274(d) to the Code, which ties to market interest rates the test rate of interest to be used for purposes of income taxation on installment sales, thus conforming those rates to the interest rates applicable to valuation under 26 U.S.C. 2512 of gifts effectuated by installment sales.

1. a. The court of appeals correctly held that Section 483 had no role in determining for gift tax purposes under Section 2512(b) the value of the installment payments petitioners received in exchange for their stock. Petitioners made a taxable gift of approximately $3.3 million when they transferred to the trusts stock with a fair market value of $7,954,046.60 in exchange for notes with an aggregate fair market value of only $4,601,551.

It has long been settled that, in order to determine whether a transfer of property has effected a gift, the value of any note issued as complete or partial consideration for the transfer must be taken into account at its fair market value, not at its face value. *E.g.*, *Blackburn* v. *Commissioner*, 20 T.C. 204 (1953); *Estate of Berkman* v. *Commissioner*, 38 T.C.M. (CCH) 183 (1979); cf. *Mason* v. *United States*, 513 F.2d 25 (7th Cir. 1975). Fair market value is a function of the market interest rate, the date of maturity of the instrument, and other pertinent factors such as security for the obligation and the solvency of the debtor. *Blackburn*, 20 T.C. at 207; *Estate of Berkman*, 38 T.C.M. (CCH) at 187. The IRS thus correctly relied on the 11.5 percent prevailing market interest rate at the time of the transfers to determine the value of petitioners' gifts under Section 2512(b).

In arguing that the IRS should have used the Section 483 test rate, rather than the market interest rate, in determining the current fair market value of the installment payments under their contract, petitioners rely principally on the language in Section 483(a) stating that its provisions are applicable "[f]or purposes of this title." Pet. 9-13. They reason that because the term "title" refers to the entire Internal Revenue Code, which includes, *inter alia*, subtitle A (income taxes) as well as subtitle B (estate and gift taxes), the Section 483 test rate applies to gift tax valuations as well as income tax assessment. Pet. 10-11. Petitioners read Section 483 to provide that a bargain sale using the Section 483 test rate is thereby immune from the provisions of Section 2512 that impose a gift tax on bargain sales of property. Pet. 15; see also *Ballard* v. *Commissioner*, 854 F.2d at 188.

Where interest is unstated in a deferred-payment contract, Section 483 determines the portion of sales proceeds that is to be recharacterized as interest. As the court of appeals correctly held, Pet App. A16, however, that provision is not relevant for gift valuation purposes. Rather, valuation focuses on the current fair market value of the deferred installment payments. Determining current fair market value depends on the actual market interest rate that the trusts would have paid in order to defer payments for the stock. To the extent that the Section 483 test rate was not, at the time of the sales at issue here, the actual market rate, the test rate is inapplicable to the gift valuation question.[4]

---

[4] Petitioners seek to rely on proposed regulations that the Treasury Department released in 1986, which took the position that Section 483 would be relevant in determining the value of

b. Contrary to petitioners' contention (Pet. 16-19), the court of appeals' decision does not impose on petitioners inconsistent treatment under the income tax laws and the gift tax laws. First, because petitioners specified a six percent interest rate, no recharacterization of principal amounts was called for and that aspect of Section 483 by its terms simply did not apply to their transactions. It followed that those transactions were subject to the same gift and income tax consequences that obtained with respect to all similar bargain sales transactions made prior to 1964, when Section 483 was adopted. Second, although Section 483 prevented petitioners from understating the portion of payments they received that constituted interest, it did so only up to a point. The parties stipulated that, when the transactions at issue took place, the relevant market interest rate (11.5 percent) exceeded the six percent test rate. The effect of the Section

---

a below-market debt instrument for gift tax purposes. Pet. 13-14. Because those proposed regulations were never adopted, they are without legal significance. Moreover, as the Tax Court has noted, the IRS in 1986 took inconsistent positions as to whether Section 483 had any relevance for gift tax purposes. *Frazee* v. *Commissioner*, 98 T.C. 554, 581-582 (1992). While the proposed regulations suggested that Section 483 is relevant to valuation for purposes of the gift tax, an IRS General Counsel Memorandum (G.C.M. 39,566 (Oct. 23, 1986)) took the contrary position that Section 483 and the regulations thereunder have no relevance for gift tax purposes. The IRS's litigating position consistently has been that expressed in the General Counsel Memorandum. In any event, those regulations, proposed in 1986, would not have applied to petitioners' 1980 sales, and have since been superseded by 26 U.S.C. 1274(d) and Treasury Regulations §§ 1.483-1 to 1.483-3, adopting the Applicable Federal Rate as the Section 483 test rate. See page 8, *supra*, and pages 13-14, *infra*.

483 test rate was to limit but not eliminate petitioners' income tax advantage by allowing them to characterize more of the installment payments they received as principal than they would have been able to had interest been required to be reported at market rates. The fact that Section 483 did not also give petitioners an advantage with respect to gift tax, however, is not an inconsistency, but a reflection of the limited role of the six percent test rate.

Contrary to petitioners' suggestion, they were not required for income tax purposes to treat the amount realized on the sale as the $7,956,046.60 face amount of the notes rather than as the $4,601,551 fair market value used by the IRS in determining their gift tax liability. For income tax purposes, the taxpayer who makes a bargain sale of property realizes taxable gain to the extent the value of the consideration received exceeds his or her basis in the property sold. See 26 U.S.C. 1001. Under the express terms of Section 1001(b), the amount that petitioners realized on their bargain sale of the stock was the $4,601,551 fair market value of the notes they received from the trusts, not the $7,956,046.60 face amount of the notes. Thus, if petitioners had reported the transaction under Section 1001, their gain would have been computed under Section 1001(b) and would have been equal to the amount by which the fair market value of the notes they received exceeded their basis in the stock they transferred to the trusts.

Petitioners, however, chose to report their gain by the installment method under Section 453. By electing that method of reporting, petitioners became entitled to report the gain on a pro rata basis over the years as they received the payments on the notes from the trusts, rather than having to report the

entire gain (and pay the entire tax due thereon) in the year of the sale, as would have been required under Section 1001. In electing installment reporting under Section 453, however, petitioners were required to treat the full face amount of the notes issued by the trusts as the amount realized on the sale. It was thus petitioners' choice to defer payment of the tax under Section 453 that required them for income tax purposes to treat the amount realized on the sales as the face amount of the notes, while for gift tax purposes the notes were taken into account at their fair market value.

2. The issue presented in this case has little continuing significance to the administration of the tax laws due to the enactment of Section 1274(d) of the Internal Revenue Code in the Tax Reform Act of 1984, Pub. L. No. 98-369, § 41(a), 98 Stat. 531, 540. The inconsistency that petitioners claim the court of appeals' decision tolerates—between treatment of interest for income tax and for gift tax purposes—has been eliminated by the adoption of the market-based Applicable Federal Rate (AFR). Treasury regulations specify the AFR as the test rate under Section 483. 26 C.F.R. 1.483-1(a), 1.483-2(a)(1)(i), (2), 1.483-3(a); cf. 26 U.S.C. 7872(e)(1) (employing the AFR as the rate at which "foregone interest" will be valued in interest-free or below-market loans). The AFR thus replaces the six percent test rate for purposes of imputation of interest. The AFR is adjusted monthly. 26 U.S.C. 1274(d)(1)(B). That rate is also the market rate the IRS uses for purposes of determining the present value of installments due in an installment sale. See 26 U.S.C. 1274(b)(2)(B). Thus, if the AFR is used as the interest rate in an installment sale, there

will be no gift under Section 2512(b) effectuated by use of below-market interest rates.

Petitioners urge that, where the six percent test rate was used for purposes of determining whether an installment sale contains unstated interest, it also should be used to calculate current market value for gift tax purposes. That below-market test rate, however, no longer applies. Instead, a market-based rate applies for purposes of determining unstated interest in installment sales and for purposes of determining the present value of gifts effectuated by installment sales. The question presented in this case is thus of little continuing importance and does not warrant this Court's review.[5]

---

[5] Petitioners also erroneously assert (Pet. 19-23) that the court of appeals' decision "subverts the will of Congress" with respect to intra-family sales under Section 483(e) (formerly 483(g)). Section 483(e), unlike Section 483(a)-(c), does not use the new market-based AFR, but uses a ceiling test rate of 6 percent. See 26 U.S.C. 1274(c)(3)(F); 26 C.F.R. 1.483-3(b)(1). Section 483(e) is not at issue in this case, however, because petitioners' transactions did not involve land, and this case is thus not an appropriate vehicle for review of Section 483(e). In any event, there is no reason to believe that the test rate applicable under Section 483(e), any more than the Section 483(a) test rate petitioners used, was intended to be used for gift valuation purposes. See pages 9-13, *supra*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
RICHARD FARBER
CHARLES BRICKEN
Attorneys

APRIL 1996

APPENDIX

1. Section 1274 of Title 26, United States Code, as added by § 41(a) of the Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 531, provides in pertinent part:

26 U.S.C. 1274. Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

* * * * *

(d) Determination of applicable Federal rate

For purposes of this section—

(1) Applicable federal rate

(A) In general

In the case of a debt instrument with a term of:	The applicable Federal rate is:
Not over 3 years	The Federal short-term rate.
Over 3 years but not over 9 years	The Federal mid-term rate.
Over 9 years	The Federal long-term rate.

(B) Determination of rates

During each calendar month, the Secretary shall determine the Federal short-term rate, mid-term rate, and long-term rate which shall apply during the following calendar month.

(C) Federal rate for any calendar month

For purposes of this paragraph—

(i) Federal short-term rate

The Federal short-term rate shall be the rate determined by the Secretary based on the average market yield (during any 1-month period selected by the Secretary and ending in the calendar month in which the determination is made) on outstanding marketable obligations of the United States with remaining periods to maturity of 3 years or less.

(ii) Federal mid-term and long-term rates

The Federal mid-term and long-term rate shall be determined in accordance with the principles of clause (i).

* * * * *

2. Section 2501 of Title 26, United States Code, provides in pertinent part:

26 U.S.C. 2501. Imposition of tax

(a) Taxable transfers

(1) General rule

A tax, computed as provided in section 2502, is hereby imposed for each calendar quarter on the transfer of property by gift during such calendar quarter by any individual, resident or nonresident.

* * * * *

3. Section 1.483-1 of Title 26, Code of Federal Regulations (1995), provides in pertinent part:

§ 1.483-1 Interest on certain deferred payments.

(a) *Amount constituting interest in certain deferred payment transactions*—(1) *In general.* Except as provided in paragraph (c) of this section, section 483 applies to a contract for the sale or exchange of property if the contract provides for one or more payments due more than 1 year after the date of the sale or exchange, and the contract does not provide for adequate stated interest. In general, a contract has adequate stated interest if the contract provides for a stated rate of interest that is at least equal to the test rate (determined under §1.483-3) and the interest is paid or compounded at least annually.

* * * * *

(2) *Treatment of contracts to which section 483 applies—(i) Treatment of unstated interest.* If section 483 applies to a contract, unstated interest under the contract is treated as interest for tax purposes. Thus, for example, unstated interest is not treated as part of the amount realized from the sale or exchange of property (in the case of the seller), and is not included in the purchaser's basis in the property acquired in the sale or exchange.

* * * * *

4. Section 1.483-2 of Title 26, Code of Federal Regulations (1995), provides in pertinent part:

§ 1.483-2 Unstated interest.

(a) *In general*—(1) *Adequate stated interest.* For purposes of section 483, a contract has unstated

interest if the contract does not provide for adequate stated interest. A contract does not provide for adequate stated interest if the sum of the deferred payments exceeds—

(i) The sum of the present values of the deferred payments and the present values of any stated interest payments due under the contract; or

(ii) If the case of a cash method debt instrument (within the meaning of section 1274A(c)(2)) received in exchange for property in a potentially abusive situation (as defined in §1.1274-3), the fair market value of the property reduced by the fair market value of any consideration other than the debt instrument, and reduced by the sum of all principal payments that are not deferred payments.

(2) *Amount of unstated interest.* For purposes of section 483, unstated interest means an amount equal to the excess of the sum of the deferred payments over the amount described in paragraph (a)(1)(i) or (a)(1)(ii) of this section, whichever is applicable.

* * * * *

5. Section 1.483-3 of Title 26, Code of Federal Regulations (1995), provides in pertinent part:

§ 1.483-3 Test rate of interest applicable to a contract.

(a) *General rule.* For purposes of section 483, the test rate of interest for a contract is the same as the test rate that would apply under §1.1274-4 if the contract were a debt instrument. Paragraph (b) of this section, however, provides for a lower test rate in the case of certain sales or exchanges of land between related individuals.

(b) *Lower rate for certain sales or exchanges of land between related individuals*—(1) *Test rate.* In the case of a qualified sale or exchange of land between related individuals (described in section 483(e)), the test rate is not greater than 6 percent, compounded semiannually, or an equivalent rate based on an appropriate compounding period.

* * * * *

6. Section 25.2512-8 of Title 26, Code of Federal Regulations (1995), provides in pertinent part:

§ 25.2512-8 Transfers for insufficient consideration.

Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. * * *

(3)

95-1155

Supreme Court, U.S.
FILED
MAY 1 1996
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1995

CHARLES SCHUSTERMAN AND
LYNN N. SCHUSTERMAN,

Petitioners

vs.

UNITED STATES OF AMERICA,

Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITIONERS' REPLY BRIEF TO THE BRIEF OF THE UNITED STATES IN OPPOSITION

*RICHARD A. FRELING
JONES, DAY, REAVIS & POGUE
2001 ROSS AVENUE, SUITE 2300
DALLAS, TX 75201
(214) 969-4835

DAVID G. GLICKMAN
BAKER & MCKENZIE
2001 ROSS AVENUE, SUITE 4500
DALLAS, TX 75201
(214) 978-3057

Of Counsel:
MICHAEL J. GRAETZ
127 WALL STREET
NEW HAVEN, CONNECTICUT 06511
(203) 482-4849

**Counsel of Record for Petitioners*

9P

TABLE OF AUTHORITIES

Cases

Frazee v. Commissioner, 96 T.C.554 (1992) 3

Statutes and Regulations

26 U.S.C. § 483 ..... 1, 2, 4, 5, 6
26 U.S.C. § 483(a) 1, 3, 4
26 U.S.C. § 483(e) 3, 4
26 U.S.C. § 1001 6
26 U.S.C. § 1174 (c)(3) and (4) 3
26 U.S.C. § 1274 ..... 1, 6
26 U.S.C. § 1274 (c)(3) and (4) 3
26 U.S.C. § 1274(d) 2, 3
26 U.S.C. § 1274A 3
26 U.S.C. § 2512 ..... 3, 4
Treas. Reg. § 1.1001-1(g) 6

Other Authorities

IRS Technical Advice Memorandum 85-05-005 (Sept. 27, 1984) ... 5

RESPONDENT'S BRIEF IN OPPOSITION DODGES THE FUNDAMENTAL QUESTIONS RAISED BY PETITIONERS, AND FALSELY CONCLUDES THAT THIS CASE DOES NOT INVOLVE AN ISSUE OF CONTINUING IMPORTANCE.

Petitioners respectfully submit that the Brief for the United States in Opposition is disingenuous in its effort to persuade the Court that it should deny the Petition for a Writ of Certiorari. The Unites States ("Respondent") acknowledges that there is confusion about the correct statutory construction of section 483[1] and a conflict among the courts of appeal, but suggests that the conflict is based on an "old" statutory provision that has been amended and replaced with a new set of "time-value-of-money" rules in section 1274 that flawlessly eliminate the confusion. That is simply incorrect, as are other misstatements in Respondent's Brief. Those misstatements should be answered lest Petitioners' silence be construed as acquiescence that Respondent has unerringly found the Achilles' Heel in Petitioners' arguments.

- The disagreement between the courts of appeal is over the proper construction of the phrase "for purposes of this title", which is crucial to the continuing interpretation of the Internal Revenue Code. Respondent takes notice of the fact that section 483 is applicable "for purposes of this title", which includes *inter alia,* both subtitle A (the income tax) and subtitle B (the gift tax),[2] but provides no answer to Petitioners' contention that those words have pervasive meaning that cannot, and should not, be ignored in the absence of some unambiguous directive elsewhere in the statute or the legislative history. There is none! To the contrary, Congress has chosen to use the words "for

---

[1] All references are to Title 26 of the United States Code (the Internal Revenue Code), except where otherwise indicated.

[2] Respondent's Br. at p. 10.

purposes of this title" no less than 90 times in the Internal Revenue Code, and it clearly understands the meaning of the phrase.[3] Respondent ignores the importance of construing consistently the phrase "for purposes of this title". Instead, Respondent's only rebuttal is to rehash the opinion of the court below which, we submit, likewise ducked the real issue of statutory construction. By paying lip service to and then disregarding the phrase "for purposes of this title", the court below violated one of the cardinal principles of statutory construction and in the process destroyed the intricate relationship between section 483 and other sections of the Internal Revenue Code.[4]

- Respondent would have the Court believe that the Internal Revenue Service actually "valued" the installment notes received by Petitioners from their childrens' trusts for gift tax purposes, but this is a mischaracterization. Instead, the Internal Revenue Service merely substituted a higher interest rate than the "safe harbor" rate specified in section 483 for the purpose of discounting the installment notes to determine their alleged present value under the gift tax. That is precisely what section 483 was designed to prevent "for purposes of this title."[5]
- Most importantly, Respondent states that "[t]he issue presented in this case has little continuing significance to the administration of the tax laws due to the enactment of section 1274(d) of the Internal Revenue Code in the Tax Reform Act of 1984 [citation omitted]."[6] Therefore, Respondent says, "[t]he question presented in this case is

---

[3] Petition at pp. 10-11.

[4] Petition at p. 23 *et seq.*

[5] Petition at p. 15.

[6] Respondent's Br. at p. 13.

thus of little continuing importance and does not warrant this Court's review."[7] This is demonstrably wrong. Section 483(e), as well as sections 1274 (c) (3) and (4) and 1274A, all provide fixed "safe harbor" interest rates that differ substantially from the floating APR rate imposed for general application. Consequently, the issue before the court is alive and well today, and any taxpayer that relies on one of these statutory "safe harbor" rates in making an intra-family sale will do so at his or her own risk if Respondent's position prevails. A prime example of that risk is the decision of the Tax Court in *Frazee v. Commissioner,*[8] which emasculated section 483(e) and subverted the clear will of Congress. Although Respondent urges that this case is not an appropriate vehicle for review of section 483(e) because this case did not involve a sale of land, *we hasten to point out that the purpose and language of the "safe harbor" rates in sections 483(a) and 483(e) are identical,* so the decision of the court below validates an ongoing trap for the unwary taxpayer.[9] Respondent waited until the last sentence in the last footnote of its Brief to signal clearly that the Internal Revenue Service will attack under the gift tax intra-family sales of land that fall squarely under the protection of sec-

---

[7] Respondent's Br. at p. 14.

[8] 96 T.C. 554 (1992), discussed in Petition at p. 21.

[9] This is equally true of the "safe harbor" rates in sections 1174(c)(3) and (4) and 1274A. Even more diabolical, there is typically a spread between the AFR and the prevailing prime interest rate at any point in time, and if the value of the intra-family sale was great enough, there is nothing explicit in section 1274(d) that would preclude the Internal Revenue Service from seeking to impose a gift tax under section 2512 based on that spread; (though Respondent apparently concedes in its brief that it would not elect to do so).

tion 483.[10] Delaying the resolution of the proper construction of the phrase "for purposes of this title," as well as the other issues in this case, will only perpetuate taxpayers' confusion and engender further litigation with the Internal Revenue Service.

- Furthermore, by suggesting that this case has "little continuing significance", Respondent also blithely dismisses as having little importance the proper construction of the phrase "for purposes of this title" (or variations thereof, such as "for purposes of this subtitle"), which Congress uses repeatedly to expand or limit the scope of particular provisions in the Internal Revenue Code. We cannot stress too much how important it is for tax compliance and proper tax administration for the Court to restore confidence in the unambiguous meaning of this key phrase.

- Respondent dismisses Petitioners' reference to regulations proposed by the Treasury Department on April 8, 1986,[11] which explicitly construe section 483 as governing valuations under section 2512 of the gift tax, on the grounds that they have never been adopted in final form and, therefore, are without legal significance.[12] Once again, that misses our point about a principle of statutory construction that precludes the courts from tinkering with unambiguous statutory language. We do not rely on the proposed regulations as substantive authority, but we do believe it is informative that a deliberative administrative process construed the words "for purposes of this title" in precisely the

---

[10] The last sentence of fn. 5 reads as follows: "In any event, there is no reason to believe that the test rate applicable under section 483(e), any more than the section 483(a) test rate petitioners used, was intended to be used for gift tax purposes."

[11] Petition at pp. 13-14.

[12] Respondent's Br. at fn. 4.

same way urged by Petitioners. Furthermore, Respondent cites an IRS General Counsel Memorandum that reaches a conclusion contrary to the proposed regulations and ostensibly represents the government's "litigating position."[13] It is indisputable that in the hierarchy of administrative pronouncements proposed regulations would trump a General Counsel Memorandum. Therefore, one might legitimately ask why after 10 years the proposed regulations have never been withdrawn? The reality is that Respondent is litigating against one of its own public pronouncements.

- Finally, Respondent suggests that Petitioners' plight was of their own making, because they had the unequivocal right to report the transaction in the year of sale (rather than on the installment method) by valuing the installment notes at their alleged discounted fair market value (not the face amount).[14] In the first place, the taxes associated with that decision would have been so horrendous that it most certainly was not a practical option. As we pointed out, reporting the transaction in the year of sale at the alleged discounted value of the installment notes would not have reduced by one penny the amount of income to be reported by Petitioners, but would have exacerbated the problem by transforming capital gain into ordinary income (tantamount to the alleged foregone interest) taxable at a higher rate.[15] Section 483 was explicitly designed to preclude that result if the interest

---

[13] Respondent's Br. at fn. 4. Respondent also fails to point out that in Technical Advice Memorandum 85-05-005 (Sept. 27, 1984), the IRS held that there was no "related party" exception in section 483 and that it applied for *all* purposes of the Internal Revenue Code.

[14] Respondent's Br. at p. 12.

[15] Petition at pp. 16-18.

rate specified in the installment note was at least equal to the "safe harbor" rate. Furthermore, it is not at all clear that Petitioners even had that option.[16]

---

[16] Treas. Reg. § 1.1001-1(g), adopted January 27, 1994, which clearly states that if a debt instrument issued in exchange for property bears adequate interest as prescribed by sections 483 or 1274, the amount realized under section 1001 is the face amount (or "issue price") of the debt instrument.

In summation, Petitioners submit that the decision of the court below could affect countless unsuspecting taxpayers, and that Respondent's Brief camouflages the real issues of proper statutory construction and the impact of that decision on intra-family transactions that Congress intended to protect. We again urge the Court to grant the writ of certiorari.

Respectfully submitted,

*RICHARD A. FRELING
Jones, Day, Reavis & Pogue
2001 Ross Ave., Suite 2300
Dallas, TX 75201
(214)969-4835

DAVID G. GLICKMAN
BAKER & MCKENZIE
2001 Ross Ave., Suite 4500
Dallas, TX 75201
(214)978-3057

Of Counsel:
MICHAEL J. GRAETZ
127 Wall Street
New Haven, CT 06511
(202)432-4828

**Counsel of Record for Petitioners*

Dated April 30, 1996